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Province of British Columbia

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The Honourable Claude Richmond
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
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Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2002/2003: Report 4 on Monitoring the Government's Finances.

Wayne Strelioff, CA
Auditor General

Victoria, British Columbia
September 2002

copy: Mr. E. George MacMinn, Q.C.
Clerk of the Legislative Assembly

Auditor General's Comments 1

Overall Picture in 2002 3

Part 1: Financial Measures and Trends in British Columbia

Telling the Financial Story Clearly 9

Revenue Trends 15

Expense Trends 19

Annual Surplus/Deficit Trend 23

Asset Trends 24

Liability Trends 28

CICA Indicators of Financial Condition 30

Part 2: Comparing British Columbia to Other Canadian Jurisdictions

The Big Picture—Where Do We Stand? 41

Response from the Ministry of Finance 51

Glossary 57

Appendices

Appendix A: Excerpts from the 2001/02 Public Accounts Overview 61

Appendix B: Gross Domestic Product (GDP) per Capita 65

Appendix C: Net Liabilities to Gross Domestic Product (GDP) 67

Appendix D: Credit Ratings 69

Appendix E: Office of the Auditor General: 2002/03 Reports Issued to Date 71

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Wayne Strelioff, CA
Auditor General

The need for clear discussion and analysis of government finances has been a recent focus of Canada's financial standard setting institutions. In January 2002, I tabled a report similar to this one urging the government to use an appropriate framework of financial information to better explain the state of its finances. To demonstrate what I was advocating, I described the financial condition of the government of British Columbia from where I stood.

Four simple principles guided me in preparing the financial framework included in that report:

1. *I thought of the government as a single entity.*

   I looked beyond internal accounting adjustments and transfers to and from different accounts that, in my view, make explaining the government's overview of its finances difficult.

2. *I embraced all of the accounting principles for government that are generally accepted in Canada.*

   With only a few exceptions, the accounting policies adopted by the British Columbia government follow these generally accepted principles.

3. *I looked at the government's operations from the perspective of the burden on the taxpayer.*

   The government's operations include commercial enterprises such as BC Hydro, which are profitable, and general programs such as health care, the cost of which must be supported by taxpayers. As does the government, I distinguished between these two types of operations.

4. *I used only reliable information.*

   To ensure reliability of the result, I took financial information from sources I was comfortable with. These were audited statements, the annual Budgets and Estimates, and reports published by credible third-party agencies.

I repeat my review this year, and again present my understanding of the government's finances. I believe citizens of British Columbia and their elected representatives want to know whether their government's finances are getting stronger or weaker, which revenues and expenses are increasing or decreasing, and how the province compares in these respects with other jurisdictions.

Auditor General's Comments

As I prepared this review for the second time, I reflected on the response to the similar report I tabled in the Legislative Assembly in January. The government suggested I had gone beyond my usual commentary on the Summary Financial Statements. This is true. While I will continue to comment on the Summary Financial Statements separately, I will also continue my commitment to help legislators and the public get the best information for assessing the performance of government. This is a major goal of my Office and I intend to work hard to achieve it.

I acknowledge and welcome the government's continued efforts to improve the form and content of the Estimates and its Summary Financial Statements, without which the information used in this report would not be available. One purpose of this report is to continue encouraging the government to improve the quality of the financial accountability information provided in its public reports.

In Part 1 of this report, I present information about the revenues, expenses, assets and liabilities of the government. To help explain the financial information clearly, I have used a simple framework (as in my January report) which distinguishes between the government activities that support its general programs and the activities that support its commercial operations. I initially wanted to prepare this information for a 10-year period, but some necessary data for years prior to 1997 is unavailable. I also wanted to compare the planned to actual results. Again, however, I found it difficult to put the necessary information together. Also in Part 1, I examine trends in several important financial indicators.

In Part 2 of the report, I compare British Columbia with other Canadian jurisdictions by looking at the changing trends in three main indicators of the government's overall fiscal performance.

Overall Picture in 2002

In the year ended March 31, 2002, British Columbia incurred an annual deficit of $1.0 billion. Two significant decisions by government resulted in some unusual gains and losses. The first decision was to move the Municipal and Teachers' pension plans into joint trusteeship arrangements. This decision extinguished on settlement the government's liability for those pension plans. Removing this obligation from the government books results in a gain of $1,464 million (loss of $52 million in 2001) which is treated as unusual revenue ("expense" in 2001). The decision to move the pension plans into joint trusteeship arrangements was made by the previous government and came into effect in the 2001/02 fiscal year.

The second decision, to restructure the public service, was made by the present government. The cost to reduce staff and terminate certain obligations in the 2001/02 fiscal year amounted to $0.5 billion—$0.3 billion was incurred in the general programs of government and $0.2 billion was incurred by government enterprises. This is an unusual expense in that it will only happen in years when significant restructuring takes place. Thus, the annual deficit for 2001/02 would have been $2.0 billion had it not been for the pension settlement gain of $1.5 billion and the $0.5 billion cost of restructuring the public service.

The government's financial trends over the last six years on revenue, expense, surplus/deficit, assets, liabilities and net liabilities are shown in Exhibit 1. The overall financial position deteriorated in 2002 by $1.0 billion. This means that the current and future citizens of British Columbia are now burdened by $23.1 billion of net liabilities ($21.3 in 2001) against which they own infrastructure assets with a depreciated value of $21.3 billion ($20.5 billion in 2001).

In 2002, for the first time, the province became eligible to receive federal equalization payments.

Exhibit 1

Financial Information Framework, 1997 to 2002

This financial information framework is built around the activities of the government's general programs and enterprises

Revenue and Expense
For the Years Ended March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002
General programs						
Revenue	22,630	23,048	22,940	24,552	27,243	27,676
Expense	23,942	25,009	25,405	25,818	27,488	29,769
	(1,312)	(1,961)	(2,465)	(1,266)	(245)	(2,093)
Enterprises						
Revenue	7,884	8,284	9,434	10,380	14,496	13,149
Expense	6,809	6,958	7,914	9,088	12,771	12,064
	1,075	1,326	1,520	1,292	1,725	1,085
Annual surplus/(deficit)	**(237)**	**(635)**	**(945)**	**26**	**1,480**	**(1,008)**

Assets and Liabilities
As At March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002
General programs						
Financial assets	6,419	6,795	7,018	9,163	9,057	9,129
Liabilities	28,651	29,737	31,011	33,828	33,796	35,159
	(22,232)	(22,942)	(23,993)	(24,665)	(24,739)	(26,030)
Enterprises						
Assets	17,760	18,439	19,299	18,814	19,387	18,669
Liabilities	14,819	15,267	16,013	15,655	15,964	15,760
	2,941	3,172	3,286	3,159	3,423	2,909
Net liabilities	**(19,291)**	**(19,770)**	**(20,707)**	**(21,506)**	**(21,316)**	**(23,121)**
General infrastructure assets	18,518	18,362	18,354	19,179	20,469	21,266
Accumulated deficit	**(773)**	**(1,408)**	**(2,353)**	**(2,327)**	**(847)**	**(1,855)**

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Crown corporation financial statements

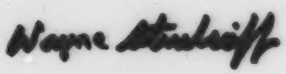
Auditor General's Comments

Credit rating agencies still regard British Columbia as being the second lowest credit risk of all provinces in Canada, after Alberta. During the 1997/98 fiscal year, British Columbia's credit rating dropped from the highest in the country to parallel that of Alberta. During the 1999/2000 fiscal year Alberta's position improved, and it has since remained stronger than British Columbia's.

In 2001/02, British Columbia's Gross Domestic Product (GDP) per capita was below Canada's average. British Columbia ranked fourth amongst the provinces in that measure, behind Alberta, Ontario and Saskatchewan. This was also the ranking in 2000/01.

We were able to compare British Columbia's net debt to GDP with only two other provinces for 2001/02, because the majority of provinces have not yet published their audited annual summary financial statements.

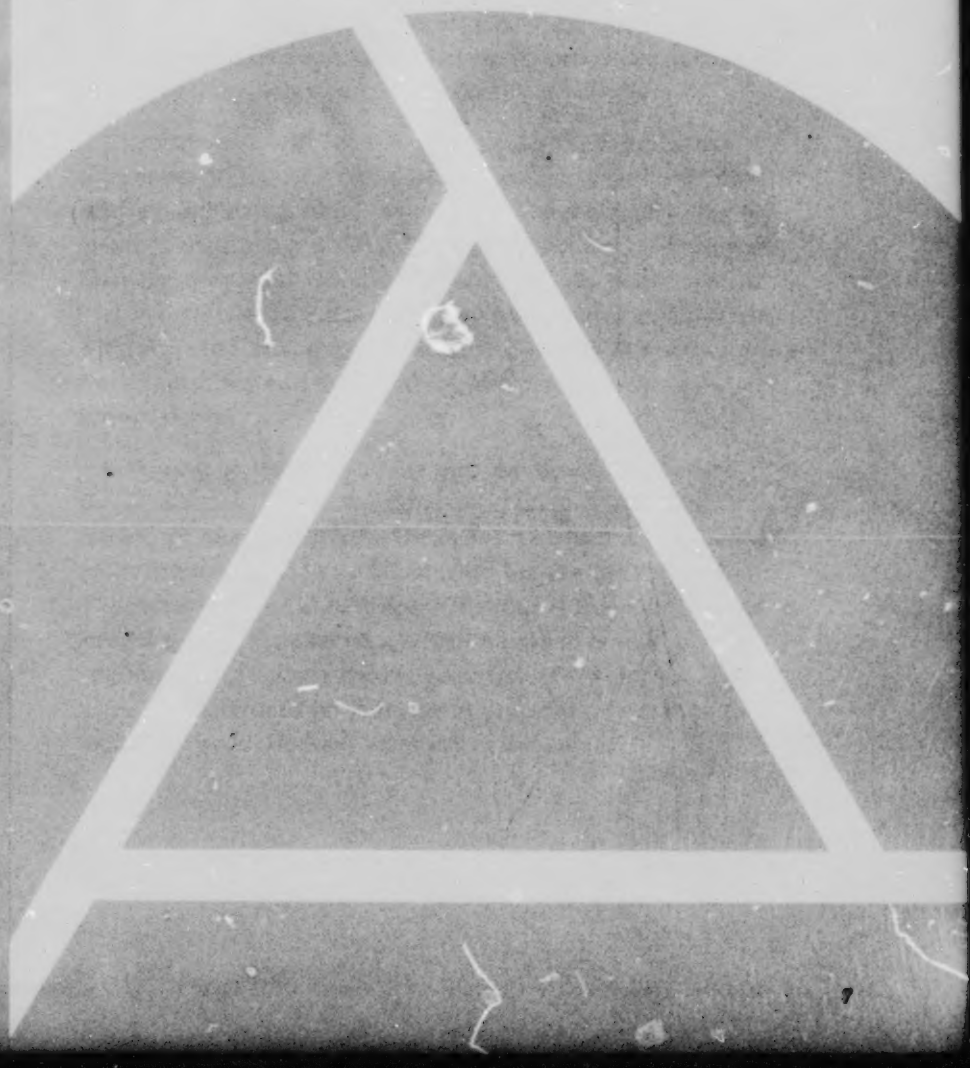
The provincial government is committed to adopting fully, by April 1, 2004, the Canadian generally accepted accounting principles for senior governments. This change presents the government with a good opportunity to revisit its financial reporting as a whole. My Office is eager to play a supportive role in this matter. The recommendations in this report are an important starting point, as they are aimed at addressing the need for better discussion and analysis by government of its finances.



Wayne K. Strelioff, CA
Auditor General

Victoria, British Columbia
September 2002

Part 1:
Financial Measures and Trends in British Columbia



Telling the Financial Story Clearly

The annual financial statements of an organization usually offer the most conventional explanation of that organization's finances. Because these statements are often complex, many large organizations, including some governments, also use their annual reports to tell their financial stories in a more clear, concise and reader-friendly way.

In recent months, those who uphold the integrity of the assurance business in Canada—for example, security commissions and standard-setting institutes—have frequently commented on the difference between the *acceptability* and the *quality* of audited financial information.

Acceptability refers to the required standards of financial statement presentation. These standards are called Generally Accepted Accounting Principles, or GAAP for short. Quality refers to the users' expectation that the reporting organization tells its financial story completely and clearly.

Attention to quality in financial reporting is not a new phenomenon. A few years ago, in a Canadian legal battle, the courts ruled that auditors cannot hide behind GAAP if they are aware that adhering to GAAP alone does not ensure getting the financial story right. To help legislators and the public receive the best information for assessing the performance of governments, legislative auditors across Canada often suggest ways to improve the acceptability and quality of the information provided by governments.

I bring up this matter here because those who prepare the government financial statements in this province frequently remind us that, except for a few instances which are explained in the Summary Financial Statements, the government of British Columbia follows GAAP. I agree that this is true, but I do not believe that—when we all are determined to rebuild public confidence in the institution of government—following GAAP alone is sufficient to provide useful financial information to legislators and interested members of the public.

Part 1: Financial Measures and Trends in British Columbia

In British Columbia, over the last few years much has been done by the government to ensure it is telling its financial story like it is. Nevertheless, I think that the financial information the government publishes annually to monitor its finances (including the Summary Financial Statements) still needs improvement if the financial story is to be easy to understand and meaningful to both legislators and the public. For example, the government currently provides an overview in the Public Accounts to explain its finances. I am pleased to see this written commentary on financial performance. However, these accounts, which are referred to as summary accounts (not to be confused with the Summary Financial Statements), are incomplete and very difficult to understand. (They are reproduced in Appendix A of this report for reference.) I had to work hard to understand the intended message in these accounts, whose purpose is to compare the government's planned financial performance (based on the Estimates) to its actual results (based on the Summary Financial Statements). The comparison becomes especially awkward because there are significant differences in the accounting of the two sets of information. The biggest difference is that the Summary Financial Statements fully consolidate taxpayer-supported organizations but the Estimates do not.

The following is my interpretation of how the government explained its financial results for the year ended March 31, 2002, in its financial reporting overview:

	$ Million
The government's main operating account, the Consolidated Revenue Fund (CRF), has ended the year in a deficit.	$(1,695)
The taxpayer-supported Crown corporations ended the year in an operating deficit.	(240)
Adjustment needed because dividends received by the CRF from taxpayer-supported Crown corporations are, in effect, money transferred from one pocket to another.	(273)
Fourteen accounting adjustments were made to the results mentioned above, ranging from $189 million to $1 million. These resulted in a small negative adjustment overall.	(5)
The self-supported Crown corporations ended the year in an operating surplus.	1,288
Adjustment needed because dividends received by the CRF from self-supported Crown corporations are, in effect, money transferred from one pocket to another.	(1,420)
Four accounting adjustments were made to the balances mentioned above, ranging from $157 million to $9 million. These resulted in a negative adjustment.	(352)
There was a one-time gain due to changes in pension plans.	1,464
The Government ended the year in a deficit.	$(1,233)

As I was trying to understand how the government was explaining its financial performance in its summary accounts, I noted the following:

1. The CRF is portrayed as being an organization that carries the main activities of the government and is the clearing account for all of government's operations. This is not the case in British Columbia. For example, user-paid revenue collected by the government's business enterprises matches total revenue collected by government from natural resources, federal transfers and all fees and licences. Focusing on the CRF suggests government is more of a bank account rather than a single, albeit large and complex, entity.

2. The government does not mention that the balances presented in these statements exclude the financial results of schools, universities, colleges and hospitals. The exclusion of these organizations has a significant effect on the province's overall finances. The audited Summary Financial Statements of the government for the year ended March 31, 2002 estimate that the net effect on the annual deficit would be a decrease of $225 million. Had these results been included, the government's deficit for the 2001/02 fiscal year would have been $1,008 million and not $1,233 million as shown in these accounts.

3. The government does not follow GAAP in the preparation of its Estimates to the extent the principles are being followed in its financial statements. This makes the budget-to-actual comparison awkward, requiring complicated adjustments.

4. Making sense of the summary accounts is difficult because of many inter-organizational transfers and accounting adjustments in them.

The need for developing standards to guide a government's financial statement discussion and analysis has been recently recognized by the Canadian Institute of Chartered Accountant's Public Sector Accounting Board. To this end, I believe the government should start by developing a better, easier-to-understand financial information framework to supplement the Summary Financial Statements and the Estimates. In the January report I issued this year, I presented an example of such a framework and recommended that the government use it in monitoring its finances. In my view, the recommended framework goes beyond the acceptability standards of public reporting and brings with it the improved quality of information expected by legislators and the public. That said, I would still like to amend the framework further by including the government's financial plans for the current year in it, but (for reasons I noted above) that information was unavailable. To provide that information, the government must implement GAAP fully in its Estimates as required by the Budget Transparency and Accountability Act.

In Exhibit 2, I have presented six years of information that is the basis of my comments on measures and trends in this report. It shows a detailed breakdown of revenues, expenses, assets and liabilities of the government related to its general programs and commercial enterprise activities.

The framework recommended here offers a number of important improvements:

1. It embodies all aspects of the government's operations as a single reporting entity.
2. It applies generally accepted accounting principles prescribed by the Canadian Institute of Chartered Accountants in its compilation.
3. It provides clear information on the finances of both the government's general programs and its commercial business enterprises.
4. It presents information about the current year and five prior years, restated to make the year-to-year comparison meaningful.

Recommendation:

I recommend that the government consider using the financial framework presented in this report as a model with which to supplement its financial statements and Estimates. This would help the government tell its financial story in a way that is easy to understand and useful to legislators and the public.

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4. It presents information about the current year and five prior years, restated to make the year-to-year comparison meaningful.

Recommendation:

I recommend that the government consider using the financial framework presented in this report as a model with which to supplement its financial statements and Estimates. This would help the government tell its financial story in a way that is easy to understand and useful to legislators and the public.

In this report I make use of statistical and economic data supplied to me by Statistics Canada. My convention in using this data is similar to the government in its reporting of the key indicators of provincial debt in its Public Accounts. Population data for a fiscal year is the population as at July 1 of the fiscal year. Gross domestic product and consumer price index data for a fiscal year are the amounts for the calendar year which ends in the fiscal year. In addition, unless otherwise noted, all financial data used in this report is based on that presented in the framework in Exhibit 2.

Exhibit 2

Detailed Financial Information Framework, 1997 to 2002

Revenue and Expense
For the Years Ended March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002
General programs						
Revenue						
Taxation	13,463	13,551	13,620	13,796	14,329	14,136
Natural resources	2,671	2,681	2,015	2,821	4,181	3,263
Federal transfers	2,296	2,165	2,527	2,984	3,285	3,378
Other	4,200	4,651	4,778	4,951	5,448	5,435
Unusual items	-	-	-	-	-	1,464
	22,630	23,048	22,940	24,552	27,243	27,676
Expense						
Health	7,456	7,820	8,102	8,683	9,291	10,414
Education	6,447	6,526	6,533	6,709	7,269	7,811
Social services	3,099	3,181	3,146	3,115	3,263	3,442
Interest	1,712	1,636	1,769	1,876	1,971	1,808
Other	5,228	5,846	5,855	5,435	5,642	5,947
Unusual items	-	-	-	-	52	347
	23,942	25,009	25,405	25,818	27,488	29,769
	(1,312)	(1,961)	(2,465)	(1,266)	(245)	(2,093)
Enterprises						
Revenue						
BC Hydro	2,403	2,533	3,018	3,458	7,889	6,311
Insurance Corporation of BC	2,624	2,690	2,822	2,966	2,872	2,971
BC Liquor Distribution Branch	1,543	1,598	1,645	1,671	1,732	1,798
BC Railway Company	421	427	418	479	496	440
Other	893	1,036	1,531	1,806	1,507	1,629
	7,884	8,284	9,434	10,380	14,496	13,149
Expense						
BC Hydro	2,064	2,125	2,622	2,912	7,340	6,053
Insurance Corporation of BC	2,779	2,676	2,761	2,776	2,886	3,213
BC Liquor Distribution Branch	956	992	1,029	1,054	1,090	1,161
BC Railway Company	385	387	391	1,062	502	606
Other	625	778	1,111	1,284	953	1,031
	6,809	6,958	7,914	9,088	12,771	12,064
	1,075	1,326	1,520	1,292	1,725	1,085
Total annual surplus/(deficit)	**(237)**	**(635)**	**(945)**	**26**	**1,480**	**(1,008)**

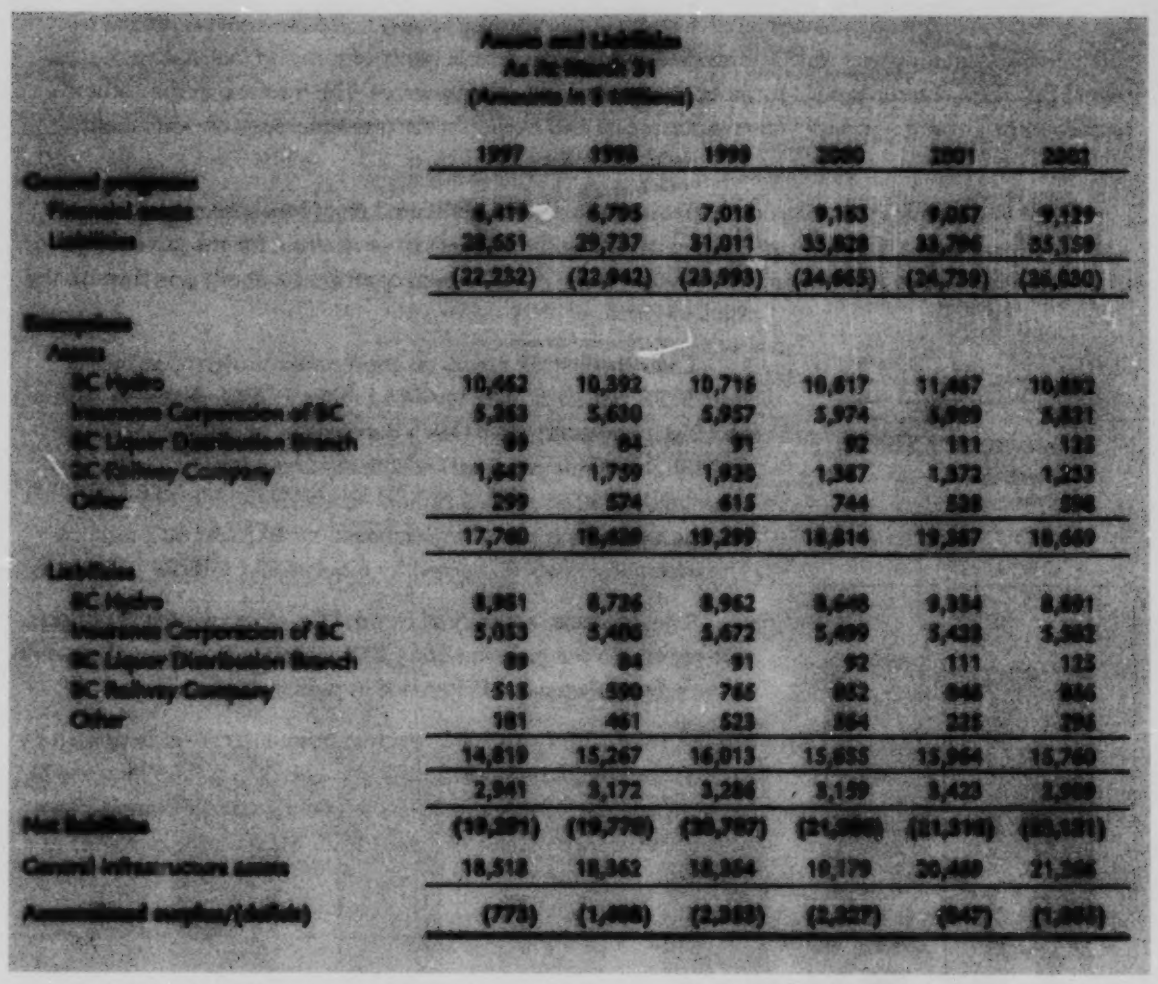
Assets and Liabilities
As At March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002
General programs						
Financial assets	6,419	6,795	7,018	9,163	9,057	9,129
Liabilities	28,651	29,737	31,011	33,828	33,796	35,159
	(22,232)	(22,942)	(23,993)	(24,665)	(24,739)	(26,030)
Enterprises						
Assets						
BC Hydro	10,462	10,392	10,716	10,617	11,467	10,892
Insurance Corporation of BC	5,263	5,630	5,957	5,974	5,909	5,821
BC Liquor Distribution Branch	89	84	91	92	111	125
BC Railway Company	1,647	1,759	1,920	1,387	1,372	1,233
Other	299	574	615	744	528	598
	17,760	18,439	19,299	18,814	19,387	18,669
Liabilities						
BC Hydro	8,981	8,726	8,962	8,648	9,354	8,891
Insurance Corporation of BC	5,053	5,406	5,672	5,499	5,428	5,582
BC Liquor Distribution Branch	89	84	91	92	111	125
BC Railway Company	515	590	765	852	846	866
Other	181	461	523	564	225	296
	14,819	15,267	16,013	15,655	15,964	15,760
	2,941	3,172	3,286	3,159	3,423	2,909
Net liabilities	**(19,291)**	**(19,770)**	**(20,707)**	**(21,506)**	**(21,316)**	**(23,121)**
General infrastructure assets	18,518	18,362	18,354	19,179	20,469	21,266
Accumulated surplus/(deficit)	**(773)**	**(1,408)**	**(2,353)**	**(2,327)**	**(847)**	**(1,855)**

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Crown Corporation financial statements.

Revenue Trends

Exhibit 3 shows the government's revenue sources from general programs and commercial enterprises. Between 2001 and 2002 there was a decrease in total revenue of $0.9 billion. Before 2002, total revenue had increased each year. Overall, the government's total annual revenue has risen from $30.5 billion in 1997 to $40.8 billion in 2002, an increase of 34%.



Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Crown Corporation financial statements.

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Exhibit 3 also shows the revenue from general programs broken down into its components of taxation, natural resources, federal transfers and other sources. The increase in the "other" component in 2002 is due to the one-time pension settlement gain of $1.5 billion.

Taxes and revenue generated from business enterprises are the two most significant sources of revenue for the government of British Columbia. In 2002, each contributed about one-third to the total revenue.

Over the last six years, taxation revenue increased by 5%, from $13.4 billion in 1997 to $14.1 billion in 2002. Between 2001 and 2002, however, there was a decrease in taxation revenue of $0.2 billion. While personal income tax and provincial sales tax decreased by $0.6 and $0.2 billion, respectively, corporation income tax and property tax increased by $0.5 and $0.2 billion. The remaining taxes decreased by a net of $0.1 billion.

The decrease in personal income tax revenue of $0.6 billion is due mainly to the government's 2001 decrease in personal taxation rates, offset by an overall increase in personal income.

Between 1997 and 2002, revenue from enterprises increased by 66%, from $7.9 billion to $13.1 billion. This $5.2 billion increase in revenue accounts for one-half of the overall $10.3 billion increase in total revenue between 1997 and 2002. Most of the increases in

Exhibit 3

Government Revenue, 1997 to 2002

Government revenue by main source ($ Billions)

	1997	1998	1999	2000	2001	2002
General programs						
Taxation	13.4	13.5	13.6	13.8	14.3	14.1
Natural resources	2.7	2.7	2.0	2.8	4.2	3.3
Federal transfer	2.3	2.2	2.5	3.0	3.3	3.4
Other	4.2	4.6	4.8	5.0	5.4	6.9
	22.6	23.0	22.9	24.6	27.2	27.7
Enterprises	7.9	8.3	9.4	10.4	14.5	13.1
Total revenue	30.5	31.3	32.3	35.0	41.7	40.8

Source: Office of the Auditor General of British Columbia

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Exhibit 3

Government Revenue, 1997 to 2002

Government revenue by main source ($ Billions)

Source: Office of the Auditor General of British Columbia

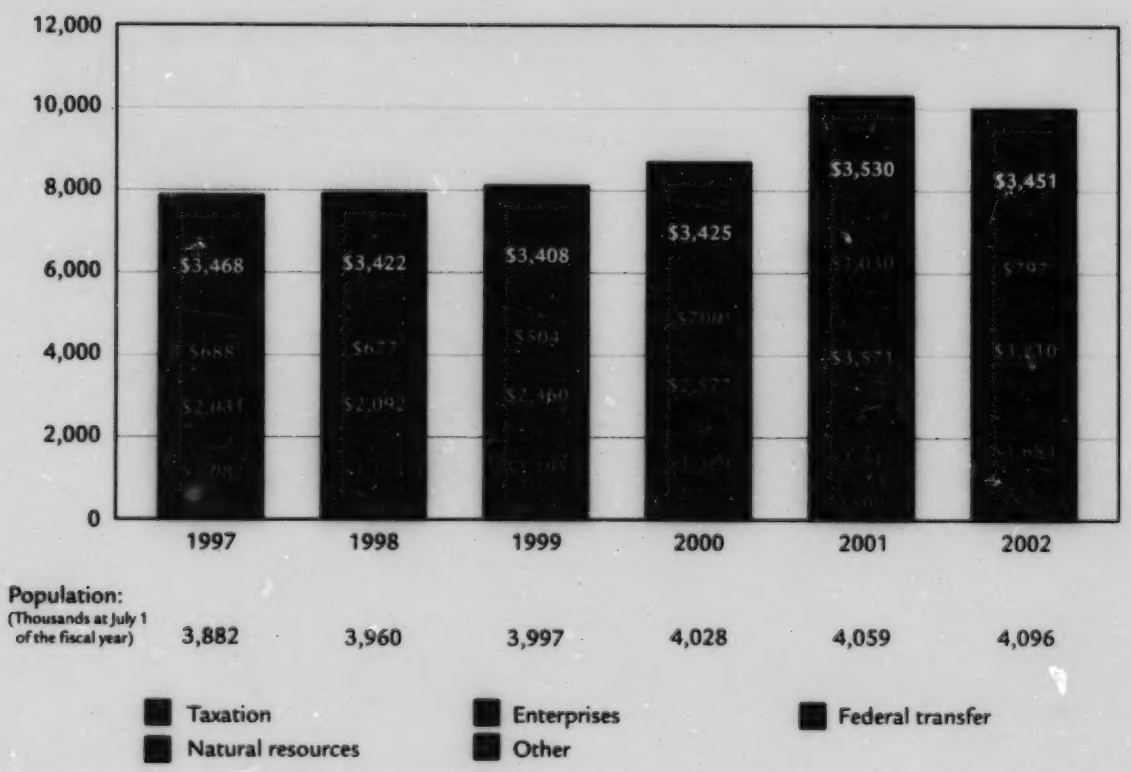
enterprise revenue are due to increases in energy sales in the BC Hydro and Power Authority. Other government commercial enterprises include the BC Liquor Distribution Branch, BC Lottery Corporation, BC Railway Company and Insurance Corporation of British Columbia.

Exhibit 4 shows the revenue per capita for each of the four general program revenue categories and for enterprises revenue. Overall, per capita government revenue increased 27%, from $7,860 in 1997 to $9,967 in 2002.

Exhibit 4

Per Capita Revenue, 1997 to 2002

Per capita revenue by main source over the past six years



Source: Office of the Auditor General of British Columbia; Statistics Canada

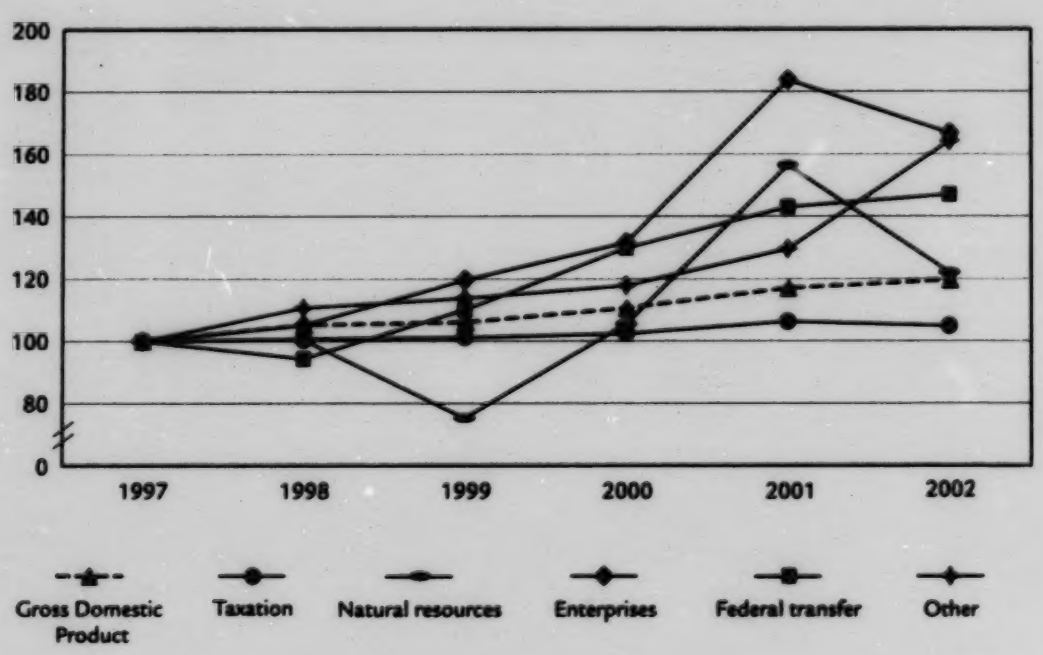
Exhibit 5 shows the rate of change in revenue over the last six years by each of the revenue components, and is compared to the increase in the province's Gross Domestic Product. The base year in this exhibit is 1997. Revenue for each main source in the five years that follow has been shown as a percentage of that for 1997.

The taxation, other and federal transfer categories generally show gradual increases in revenue over the last six years, although taxation revenue shows a slight decline in 2002 due to decreases in personal tax rates, and other revenue shows an increase in 2002 due to the gains from the settlement of pension plans. Natural resources has been the most volatile of revenue sources. Natural

Exhibit 5

Change in Revenue, 1997 to 2002

Rate of change in revenue by main source, compared to the Gross Domestic Product (GDP) (1997 = 100)



Source: Office of the Auditor General of British Columbia; Statistics Canada

resource revenue declined sharply in 1999 mainly because of decreases in forest related revenues. It then increased significantly in 2000 and 2001 because of higher oil and natural gas prices, which resulted in higher royalty sales of Crown land drilling rights—only to decline again in 2002 due to decreases in natural gas prices and sales revenue of downstream hydro-electric benefits. Revenue generated from commercial enterprises increased sharply in 2001 due to higher energy prices, which increased BC Hydro's sales revenues significantly.

Expense Trends

Exhibit 6 shows the annual expenses incurred by government, for general programs and enterprises, from 1997 to 2002.

Total government expenses increased from $30.7 billion in 1997 to $41.9 billion in 2002, an increase of 36%. Health, education and social services combined generally account for approximately 50% of the total expense of the Province.

Exhibit 6

Government Expense, 1997 to 2002

Government expense by main component ($ Billions)

	1997	1998	1999	2000	2001	2002
General programs						
Health	7.5	7.8	8.1	8.7	9.3	10.4
Education	6.9	6.8	6.5	6.7	7.3	7.8
Social services	3.1	3.2	3.1	3.1	3.2	3.5
Interest	1.7	1.6	1.8	1.9	2.0	1.8
Other	5.3	5.9	5.9	5.4	5.7	6.3
	25.5	25.9	25.4	25.8	27.5	29.8
Enterprises	5.5	7.9	7.9	9.1	12.8	12.1
Total expense	30.7	33.8	33.3	34.9	40.3	41.9

Source: Office of the Auditor General of British Columbia

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Education	6.4	6.5	6.5	6.7	7.3	7.8
Social services	3.1	3.2	3.1	3.1	3.2	3.5
Interest	1.7	1.6	1.8	1.9	2.0	1.8
Other	5.2	5.9	5.9	5.4	5.7	6.3
	23.9	25.0	25.4	25.8	27.5	29.8
Enterprises	6.8	7.0	7.9	9.1	12.8	12.1
Total expense	**30.7**	**32.0**	**33.3**	**34.9**	**40.3**	**41.9**

Source: Office of the Auditor General of British Columbia

The interest costs reported in Exhibit 6 relate only to the interest cost of general program, or taxpayer-supported, debt. To arrive at the total interest costs for government, we would need to add the interest expense of enterprises. For 2002, the general programs interest expense is $1.8 billion and the total interest expense is $2.4 billion.

Although general program debt has increased from $21.1 billion in 1997 to $28.6 billion in 2002, an increase of 36%, the related interest expense has risen by only $0.1 billion, or 6%. The reason for this comparatively small increase in interest costs is the general decline in interest rates over the last six years.

The "other" expense category includes the $347 million expense for restructuring the general programs of government during 2002 and a $52 million loss on pension settlement recorded in 2001. Both are shown as unusual items in exhibit 2. There is also a $205 million expense for restructuring included in the 2002 expenses of enterprises.

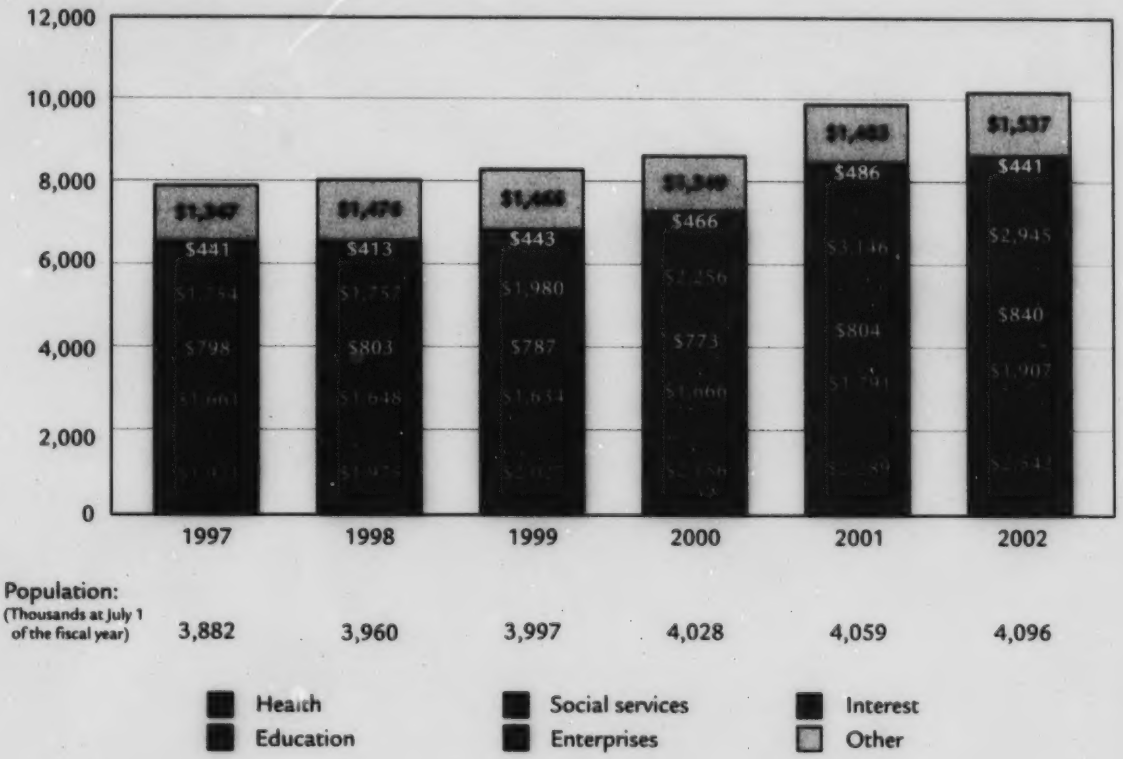
The largest increase in expense over the six-year period occurred in government enterprises, from $6.8 billion in 1997 to $12.1 billion in 2002, a $5.3 billion increase. The increase between 2000 and 2001 of $3.7 billion was largely attributable to BC Hydro's operations. The cost of electricity purchased by BC Hydro for resale made up a significant part of this increased expense in the government's commercial enterprises. These higher costs are matched by the higher revenues reported by BC Hydro for energy sales. In 2002, the commercial enterprise expenses decreased. This was largely a result of a decrease in BC Hydro's energy purchase costs during the year.

Exhibit 7 shows the government's per capita expense for the last six years, by expense category. Overall, per capita government expense increased 29%, from $7,922 in 1997 to $10,212 in 2002.

Exhibit 7

Per Capita Expense, 1997 to 2002

Per capita expense by main component over the past six years



Source: Office of the Auditor General of British Columbia; Statistics Canada

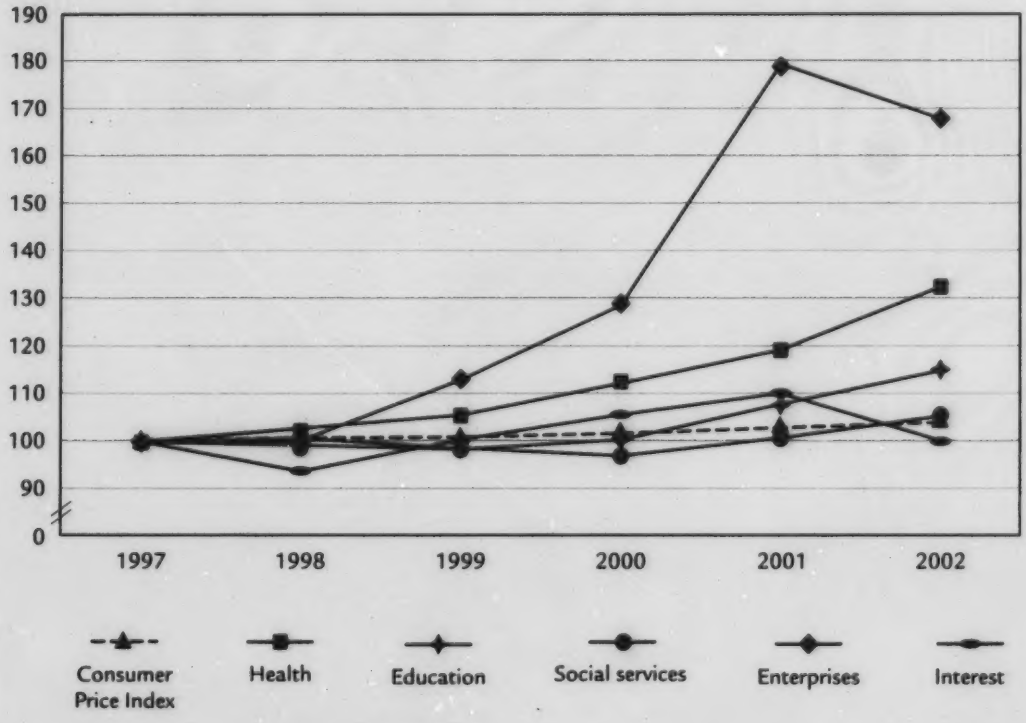
Exhibit 8 shows the rate of change in per capita expenses over the last six years for health, education, social services, interest and enterprises. To show the change over the past six years, the per capita expense in each category has been indexed to that expense in the year 1997. The expense is in actual dollars and has not been adjusted for inflation. However, the British Columbia Consumer Price Index (CPI) is plotted to show the general increase in prices in the province (also indexed to 1997) for comparison.

The sharp increase in enterprises per capita expense is mostly due to BC Hydro's operations as explained on page 20.

Exhibit 8

Change in Per Capita Expense, 1997 to 2002

Rate of change in per capita expense for health, education, social services, enterprises and interest compared to the Consumer Price Index (1997 = 100)



Source: Office of the Auditor General of British Columbia; Statistics Canada

As the exhibit indicates, relative to the Consumer Price Index, spending per capita for health has increased significantly over the last six years. Per capita spending on education and social services initially declined, but both have increased in the last two to three years.

Annual Surplus/Deficit Trend

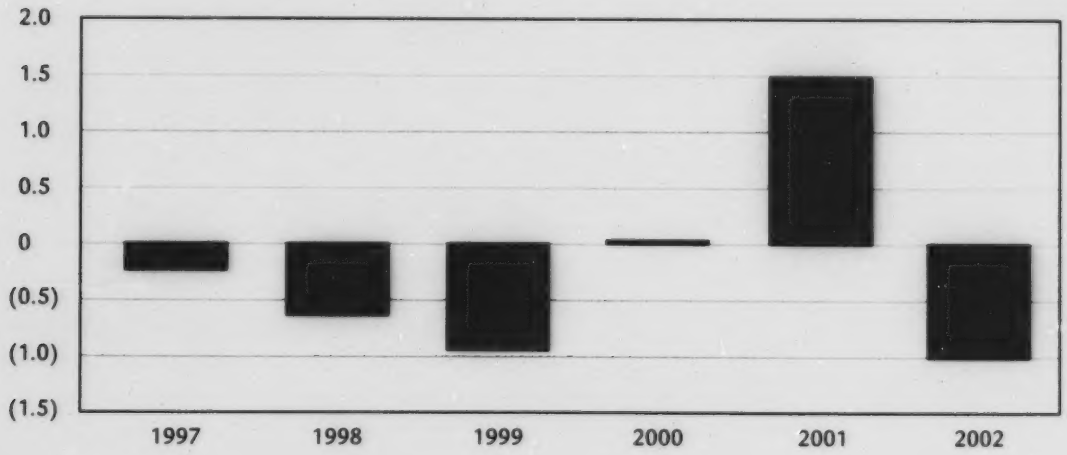
Exhibit 9 shows the trend in annual surplus/deficit for the province. A surplus occurs when annual revenues exceed expenses. A deficit occurs when expenses exceed revenues.

Between 1997 and 1999, the province recorded annual deficits ranging from $0.2 to $0.9 billion. In 2000, there was a small surplus, followed by a $1.5 billion surplus in 2001. In 2002, the province had a deficit of $1.0 billion. This figure included two unusual items: revenue from the settlement of pension plans of $1.5 billion, and government restructuring expenses of $0.5 billion. Without these unusual adjustments, the deficit for 2002 would have been $2.0 billion.

Exhibit 9

Annual Surplus/(Deficit), 1997 to 2002

The annual surplus/(deficit) ($ Billions)



Source: Office of the Auditor General of British Columbia

The difference between the $1.5 billion surplus in 2001 and the deficit before unusual items in 2002 of $2.0 billion shows a swing of $3.5 billion from 2001 to 2002. In other words, between 2001 and 2002 there was a combination of lower revenues ($2.4 billion) and higher expenses ($1.1 billion) which resulted in a swing of the finances of the Province by $3.5 billion. The unusual items decreased this change from $3.5 billion to $2.5 billion.

Asset Trends

Government assets are grouped according to their use and are considered to be either financial or physical. Financial assets are cash, investments, loans and other types of receivables. They also include inventories and amounts due from other governments. Physical capital assets are the tangible assets that the government has paid for or acquired by trading for other assets. These assets are recorded in the government's financial statements at their net book value (cost less depreciation). They exclude Crown land, forests and other natural resources that belong to the Crown.

Assets are also characterized as "revenue-generating" or "infrastructure." All assets of enterprises—financial and physical—are revenue-generating assets. Physical capital assets used in the government's general programs do not, generally speaking, generate direct revenue. They are the infrastructure needed to serve the public. Those used in government enterprises, however (such as railways, trains, hydro-electric dams, and transmission lines), do generate revenue. The distinction between revenue-generating capital assets and infrastructure assets is important because a government does not generally pay off its debt by selling the infrastructure needed to serve citizens.

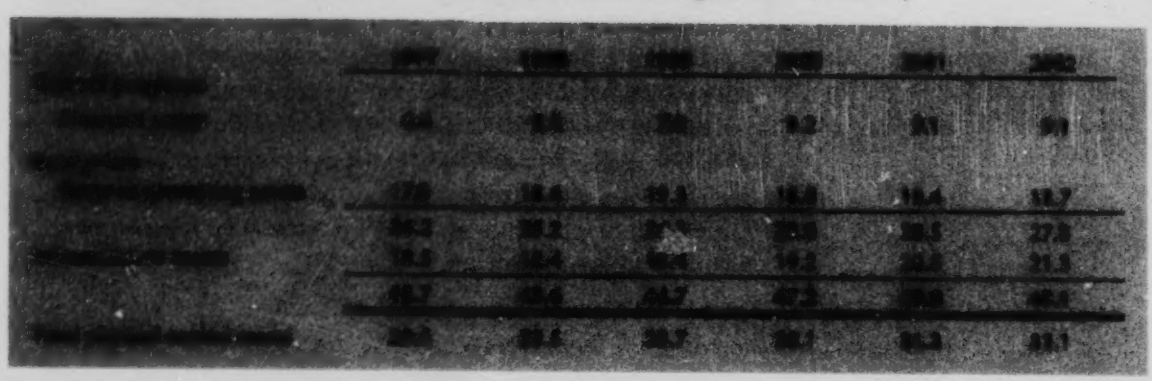
Exhibit 10 presents an overview of the categories of government assets. It also shows the value of all physical capital assets owned by the government.

From 1997 to 2002, the government's total assets increased from $42.7 billion to $49.1 billion, a six-year growth of $6.4 billion, or 15%. Increases in physical capital assets accounted for approximately 41% of this change.

Exhibit 10

Assets, 1997 to 2002

Financial, revenue-generating, infrastructure and total capital assets of the government ($ Billions)



Source: Office of the Auditor General of British Columbia

Because of British Columbia's size and geography, the need for capital infrastructure within the province is substantial. In the last six years, the net book value of infrastructure assets used within government programs (such as hospitals, other health care facilities, schools, post-secondary institutions, roads, ferries, buses and rapid transit) has increased from $18.5 billion to $21.3 billion, a 15% increase.

In the same six-year period, the value of revenue-generating assets of the government enterprises (such as those used in power generation, transmission and distribution) has increased by 5% from $17.8 billion to $18.7 billion. Revenue-generating assets of enterprises includes both physical assets and other assets.

The total value of physical capital assets owned by the government, used in both its commercial activities and general programs, has increased by 9% from $29.5 billion to $32.1 billion. The total physical capital assets include both the infrastructure assets and physical assets of enterprises.

Exhibit 10

Assets, 1997 to 2002

Financial, revenue-generating, infrastructure and total capital assets of the government ($ Billions)

	1997	1998	1999	2000	2001	2002
General programs						
Financial assets	6.4	6.8	7.0	9.2	9.1	9.1
Enterprises						
Revenue-generating assets	17.8	18.4	19.3	18.8	19.4	18.7
	24.2	25.2	26.3	28.0	28.5	27.8
Infrastructure assets	18.5	18.4	18.4	19.2	20.5	21.3
	42.7	43.6	44.7	47.2	49.0	49.1
Total physical capital assets	29.5	29.5	29.7	30.1	31.2	32.1

Source: Office of the Auditor General of British Columbia

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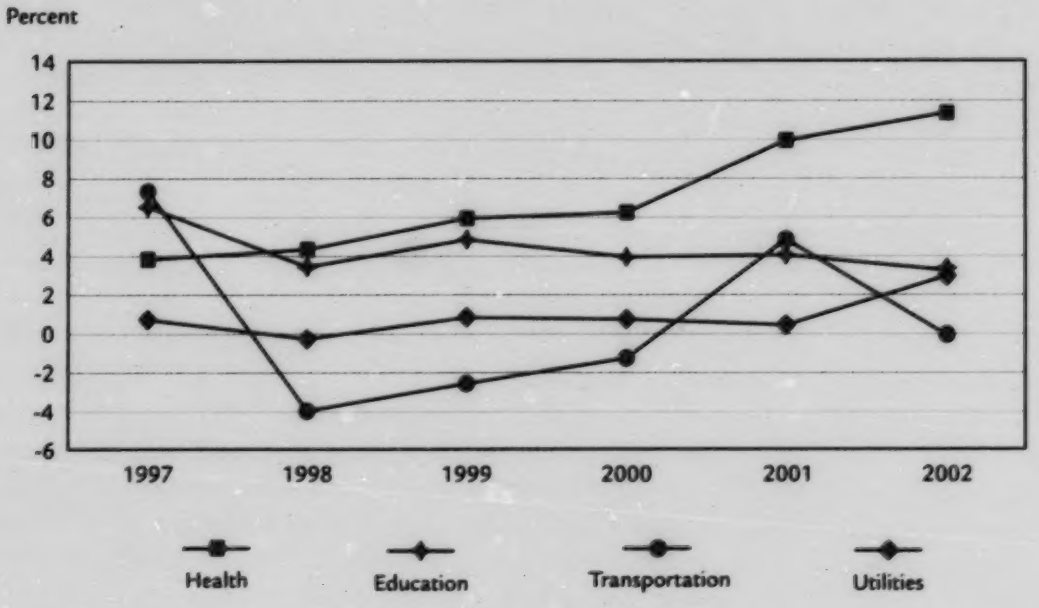
Exhibit 11 shows the percentage change in the net book value of total physical capital assets used for health, education, transportation and utilities from 1997 to 2002. The net book value change is the final result after capital additions, disposals and depreciation of the assets are taken into account. In total, the net book value of physical capital assets increased each year. In the transportation sector, however, the book value of assets decreased in 1998 , 1999 and 2000. Overall, 1998 showed the smallest increase in capital asset additions. In 1998 the government slowed capital spending—in particular that on transportation—to examine its capital investment policy and look for alternative ways to meet the province's infrastructure needs.

Exhibit 11

Change in Physical Capital Assets, 1997 to 2002

Annual percentage change in the net book value of total physical capital assets for health, education, transportation and utilities



Source: Office of the Auditor General of British Columbia

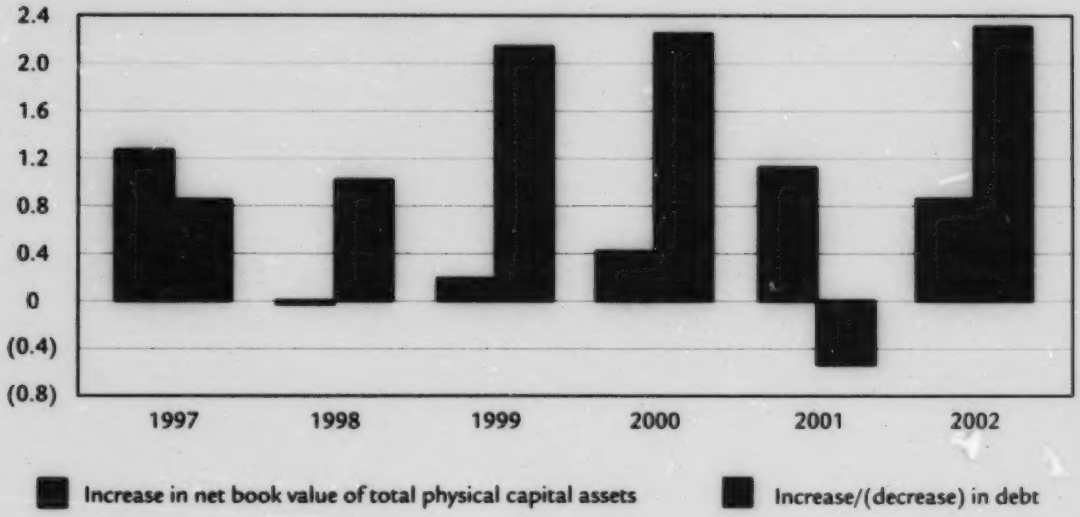
Government borrows for different reasons: it may do so to finance its operating shortfalls, to build up its stock of capital assets, to finance investment or lending, or simply to ensure that funds are there when needed. Exhibit 12 shows the increase in net book value of the government's total physical capital assets for each of the years 1997 to 2002, compared to the change in total debt each year. This graph provides a picture of how much of the change in debt is being used to provide for capital assets versus other uses of the borrowed funds.

In 1997, the increase in debt is relatively low because the government drew down funds it had borrowed and warehoused in the previous year to finance its annual deficit and capital spending. Between 1998 and 2000, the government borrowed more than was required and warehoused those funds for use at a later

Exhibit 12

Comparing Changes in Capital Assets and Public Debt, 1997 to 2002

Increase in net book value of total physical capital assets compared to change in debt ($ Billions)



Source: Office of the Auditor General of British Columbia

date. The increase in capital assets was more than offset by the increase in borrowing, suggesting that the additional borrowed funds were being used to finance annual deficits, investments, lending, or being warehoused. In 2001, the government financed its $1.1 billion increase in capital assets from its annual surplus and by selling some of its temporary investments. In 2002, in addition to borrowing $2.3 billion, the government drew down $0.2 billion in warehoused funds to pay for its increase in capital assets , to finance its annual deficit, and for other cash requirements.

Liability Trends

Government is liable for its obligations to individuals, private firms and other governments. Public debt—amounts borrowed by the government—makes up a very large part of this obligation.

Exhibit 13 shows the government's debt and other obligations for the last six years, by general programs and enterprises. Total debt has increased by $7.2 billion, or 25%, between 1997 and 2002. Total debt increased by $2.3 billion during 2002.

The liabilities of government enterprises are expected to be paid through their profitable commercial activities. The general program obligations, however, have to be met by financial assets available to government general programs, which include the net assets of the enterprises. Any shortage in the equation—referred to as "net liabilities"—will have to be borne by future taxpayers.

Exhibit 14 shows the future taxpayers' net liabilities from 1997 to 2002. Exhibit 15 provides this information in graphical form. Over the six years, net liabilities increased from $19.3 billion to $23.1 billion, an overall increase of $3.8 billion, or 20%. The largest single increase was during 2002, when net liabilities increased by $1.8 billion.

Exhibit 13

Liabilities, 1997 to 2002

($ Billions)

	1997	1998	1999	2000	2001	2002
General programs						
Debt	21.1	22.1	23.9	26.5	26.4	28.6
Other obligations	7.6	7.6	7.1	7.3	7.4	6.5
	28.7	29.7	31.0	33.8	33.8	35.1
Enterprises						
Debt	8.0	8.0	8.4	8.0	7.6	7.7
Other obligations	6.8	7.3	7.6	7.7	8.4	8.1
	14.8	15.3	16.0	15.7	16.0	15.8
Total liabilities	**43.5**	**45.0**	**47.0**	**49.5**	**49.8**	**50.9**

Source: Office of the Auditor General of British Columbia

Exhibit 14

Net Liabilities, 1997 to 2002

($ Billions)

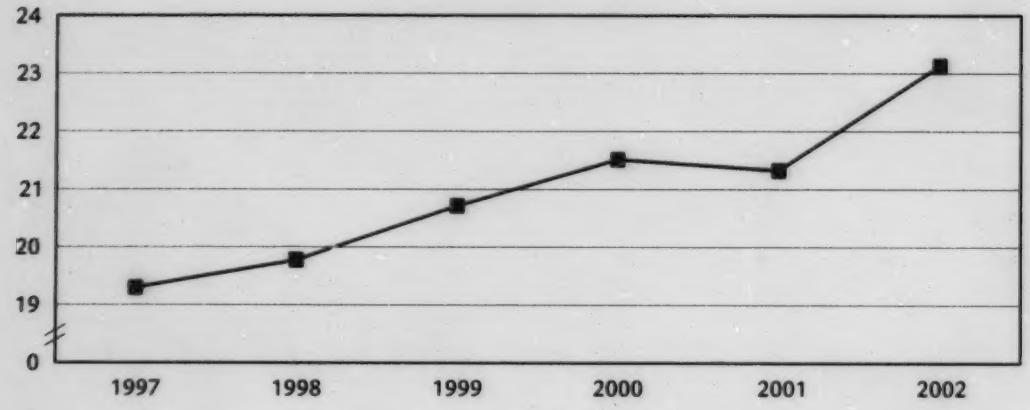
	1997	1998	1999	2000	2001	2002
Government's liabilities	43.5	45.0	47.0	49.5	49.8	50.9
Less: Financial assets (including assets of enterprises)	24.2	25.2	26.3	28.0	28.5	27.8
Net liabilities	**19.3**	**19.8**	**20.7**	**21.5**	**21.3**	**23.1**

Source: Office of the Auditor General of British Columbia

Exhibit 15

Net Liabilities, 1997 to 2002

Net liabilities represents the financial burden that current and past citizens transfer to the future taxpayer ($ Billions)



Source: Office of the Auditor General of British Columbia

CICA Indicators of Financial Condition

In 1997, a research group of the Canadian Institute of Chartered Accountants (CICA) published its report titled *Indicators of Government Financial Condition*. Senior governments and market analysts in Canada have started to use the indicators to monitor the financial condition of the federal and provincial governments with respect to the following concepts:

Sustainability—the ability of a government to maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy.

In other words: Can the government continue to spend the way it does now, and repay existing liabilities, without incurring significant amounts of new debt?

Flexibility—the degree to which a government can increase financial resources to respond to rising commitments, by either expanding its revenues or by increasing its debt burden.

In other words: If the government were to increase its spending, how much "room" is there in the provincial economy for the government to pay for the spending by increasing either taxes or debt?

Vulnerability—the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence.

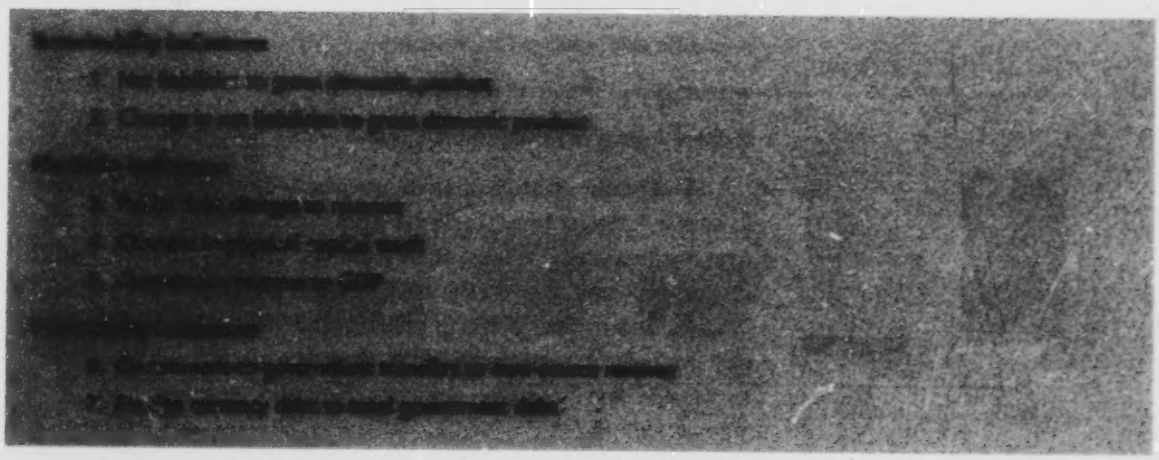
In other words: Does the government rely on revenue from the federal government—revenue that it is unable to control from year to year? Generally, a province can control its taxation policies, but it cannot control the annual transfer of funds from the federal government.

Within these three categories the CICA recommends that 10 indicators of government financial condition be reported. Seven of these are relevant to provincial governments. These are summarized in Exhibit 16.

Exhibit 16

Indicators of Financial Condition

This report presents a six-year trend for each of the CICA's indicators of government financial condition



Source: Canadian Institute of Chartered Accountants

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Exhibit 16

Indicators of Financial Condition

This report presents a six-year trend for each of the CICA's indicators of government financial condition

Sustainability indicators:

1. Net liabilities to gross domestic product
2. Change in net liabilities to gross domestic product

Flexibility indicators:

3. Public debt charges to revenue
4. Changes in physical capital stock
5. Own-source revenue to GDP

Vulnerability indicators:

6. Government-to-government transfers to own-source revenue
7. Foreign currency debt to total government debt

Source: Canadian Institute of Chartered Accountants

Sustainability Indicators

Two sustainability indicators compare the size of the net liabilities, and the annual change in net liabilities, to the size of the provincial economy. A stable net liabilities to GDP ratio indicates that the rate of growth in the economy is similar to the rate of growth in the province's net liabilities. An increasing ratio indicates that the government's current fiscal policies are increasing the financial burden on the provincial economy and on future taxpayers. A declining ratio signals the opposite.

Exhibit 17 shows the six-year trend of net liabilities to GDP for British Columbia. The ratio has remained between 16 and 18% over that time. The comparison shows a relatively stable trend, which generally means that the overall burden on taxpayers as a result of the government's fiscal policies has remained relatively constant over the last six years.

Exhibit 18 shows the change in net liabilities to GDP ratio in British Columbia for each of the past six years. There is no "correct" or "optimal" ratio of net liabilities to GDP that a government should aim to achieve. The trend should be examined in conjunction with other financial indicators of the government's finances. The fluctuation in this ratio over the past six years has been less than 2%.

Flexibility Indicators

The three indicators of government's financial flexibility are:

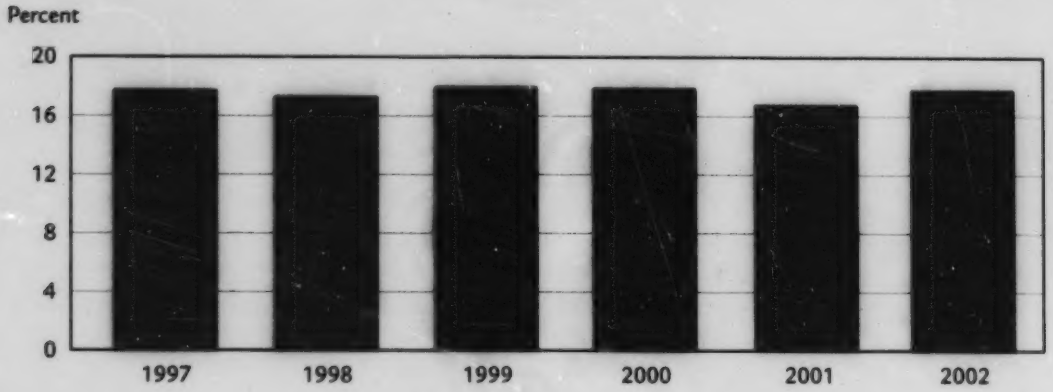
- public debt charges to revenue;
- changes in physical capital stock; and
- own-source revenue to GDP.

The public debt charges to revenue indicator is often referred to as the "interest bite." It shows how much of each dollar of the province's revenue is used to pay interest charges on debt, and it is normally measured in the form of cents per dollar of revenue. If an increasing portion of the revenue of the province is used to pay interest on government debt, then less money would be left to provide services to the citizens of British Columbia.

Exhibit 17

Net Liabilities to Gross Domestic Product (GDP), 1997 to 2002

Net liabilities as a percentage of GDP in British Columbia

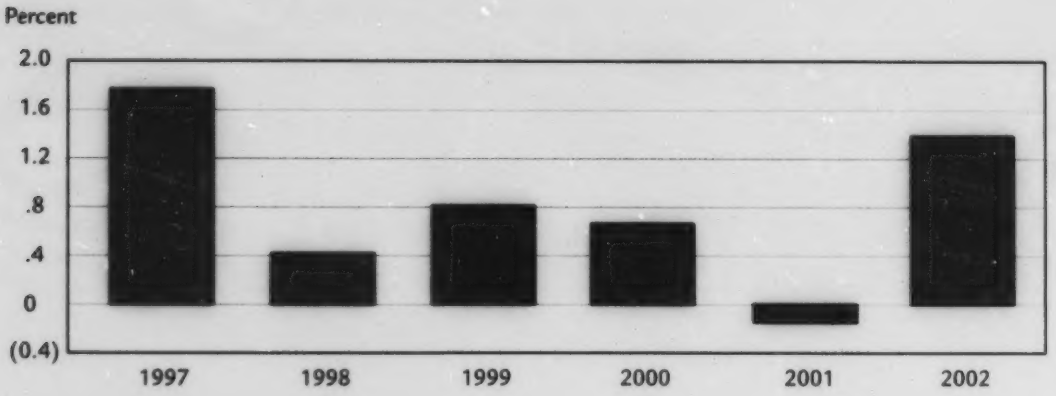


Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 18

Change in Net Liabilities to Gross Domestic Product (GDP), 1997 to 2002

Annual change in net liabilities expressed as a percentage of GDP in British Columbia



Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 19 shows the six-year trend in public debt charges to revenue. The interest bite trend for British Columbia has improved between 1997 and 2002. That improvement over the last few years was due mainly to increases in revenue (including substantial increases in hydro-electricity revenues in 2001 and the pension plan settlement gain of $1.5 billion in 2002), concurrent with the relatively flat costs of borrowing as a result of lower interest rates. The debt charges used in this indicator include both the interest expense of government's general programs and the interest included in the expenses of enterprises.

I calculated the interest bite of the province to be approximately 5.8 cents for the 2001/02 fiscal year. The government reported its interest bite to be 6.4 cents. The difference is explained mainly by the fact that I included in my calculation revenue from schools, universities, colleges and hospitals (the SUCH sector) and the gain on pension settlement.

The trend of changes in physical capital stock indicates the net amount of spending on infrastructure and other capital items by government. It is measured as the percentage change in the net book value of total physical capital assets (cost less accumulated depreciation).

This indicator emphasizes the need for governments to put in place and maintain adequate infrastructure to serve its citizens. Any deferring of expenditures on maintenance can lead to a need for expensive corrections at a later date—and such a strain on future resources reduces the flexibility of government to provide other services.

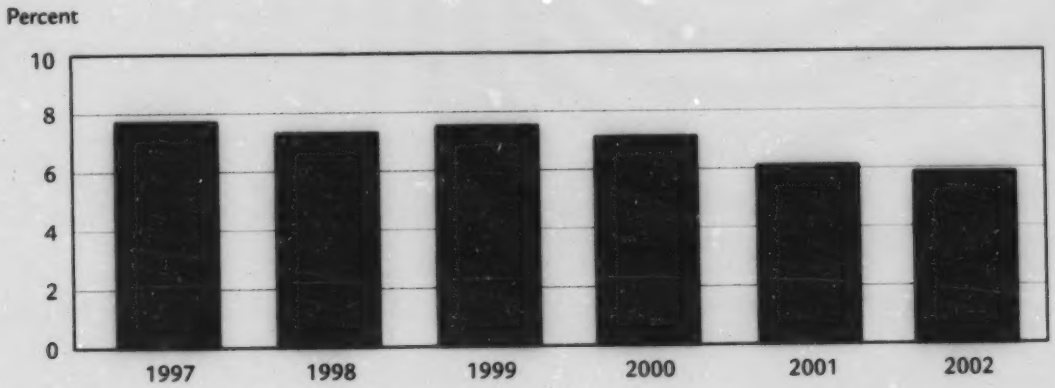
Exhibit 20 shows the annual percentage change in physical capital stock of the provincial government from 1997 to 2002. The graph indicates that the government's capital spending on total physical capital assets was constrained in 1998, but the percentage change has been larger since then.

The ratio of own-source revenue to GDP represents the extent to which the government is taking income from its own economy in the form of taxation revenue and other fees. Typically, own-source revenue is all revenue other than federal transfers. This indicator measures the percentage of revenue that a government collects directly from the value of the provincial economy.

Exhibit 19

Public Debt Charges to Revenues (the "Interest Bite"), 1997 to 2002

Total debt interest expense as a percentage of total provincial revenue

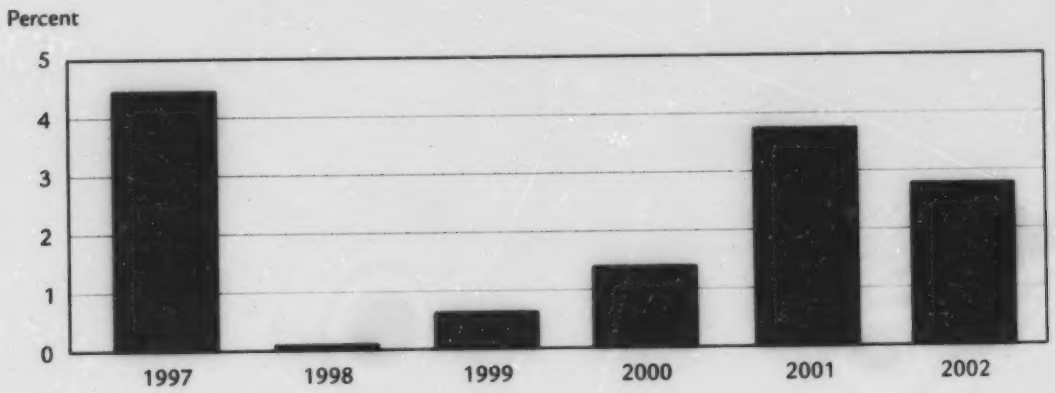


Source: Office of the Auditor General of British Columbia

Exhibit 20

Changes in Physical Capital Stock, 1997 to 2002

Annual percentage change in the net book value of total physical capital assets



Source: Office of the Auditor General of British Columbia

Exhibit 21 shows the ratio of own-source revenue to GDP for the six years 1997 to 2002. The government has generally increased its own-source revenue over that time at a pace slightly faster than the growth of the province's economy. The unusually large increase in the own-source revenue to GDP indicator in 2001 was due to the fact that there was a large increase in BC Hydro's revenue in that year.

Vulnerability Indicators

The two relevant indicators of government's financial vulnerability are:

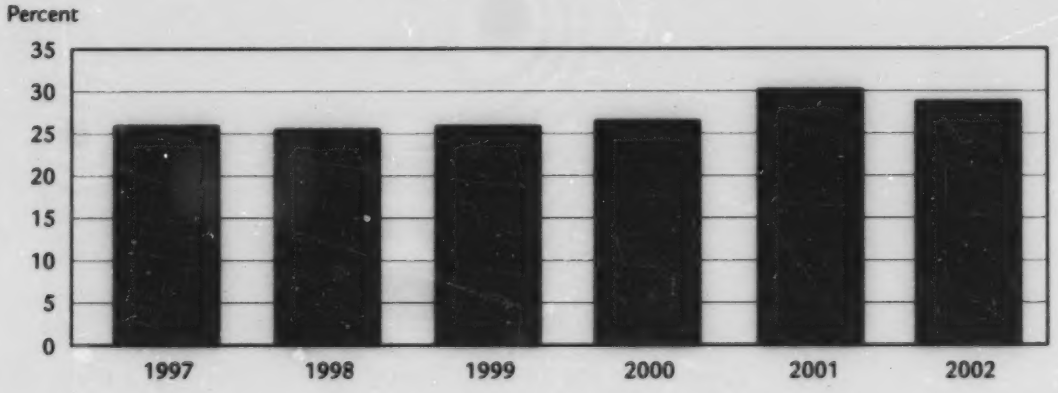
- government-to-government transfers to own-source revenue; and
- foreign currency debt to total government debt.

The idea behind this set of indicators is that funds obtained from federal or international sources (either from government transfers or borrowing) are not considered to be as controllable as revenue generated within a province. Own-source revenue is more controllable by the government through tax legislation or the charging of fees.

Exhibit 21

Own-source Revenue to Gross Domestic Product (GDP), 1997 to 2002

Provincial revenue, net of federal transfers, as a percentage of GDP in British Columbia



Source: Office of the Auditor General of British Columbia; Statistics Canada

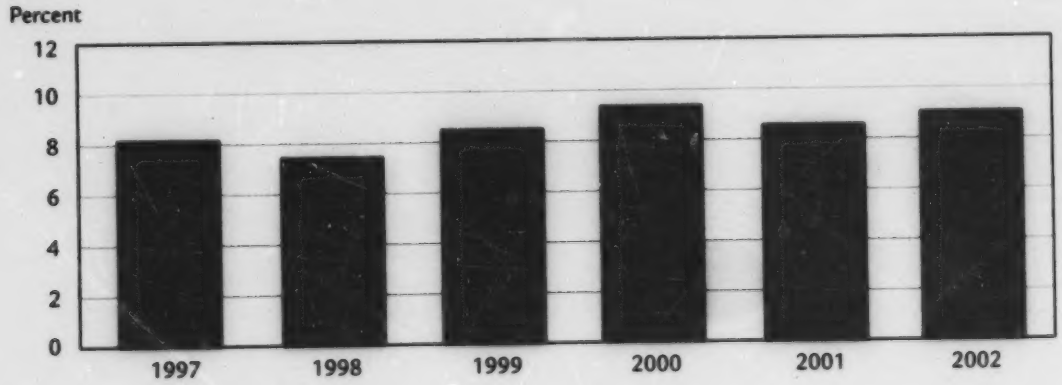
The province receives transfers from the federal government to support the delivery of health, education, social services and other programs. The government-to-government transfers to own-source revenue indicator compares federal government transfers to other provincial sources of revenue. Increases in the ratio may denote a higher dependence on the federal government as a funding source. Because the province does not generally control federal funding decisions, an increase in this ratio would add to the province's financial vulnerability.

Exhibit 22 shows the percentage of government-to-government transfers to own-source revenue for the six years ending March 31, 2002. The province's dependence on the federal government for funding has remained relatively stable over the years. A slight increase occurred in 2000 because of additional contributions received from the federal government. This was the result of a change in federal fiscal policy in that year toward all provinces. During the fiscal year 2002, the province became eligible to receive —and did receive—federal equalization payments of $226 million.

Exhibit 22

Government-to-Government Transfers to Own-Source Revenue, 1997 to 2002

Federal transfers as a percentage of all other government revenue



Source: Office of the Auditor General of British Columbia

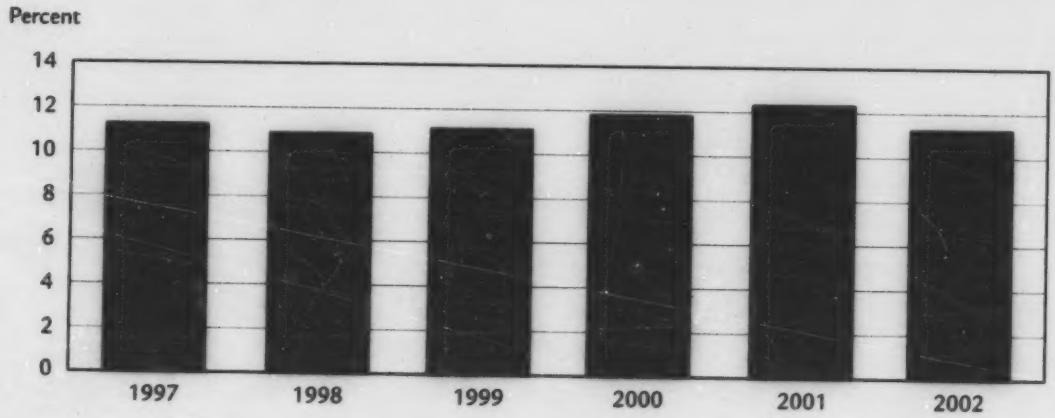
The government of British Columbia often borrows in foreign currencies. To minimize its exposure to swings in these currencies, the government enters into derivative contracts such as currency swaps and forward contracts for most foreign-denominated debt. These contracts ensure that debt repayments are fixed in Canadian dollars. For many years, information concerning public debt issued in foreign currencies has been included in a note to the government's financial statements. The note discloses any "hedging" through foreign currency derivative contracts.

The ratio of non-hedged foreign currency debt to total government debt shows the degree of vulnerability of a government's public debt position to swings in foreign currency. Tracking monies borrowed by the government in currencies other than the Canadian dollar is important because of the uncertainties associated with exchange rates when repayment comes due. Exhibit 23 shows that the non-hedged foreign currency debt as a percentage of total government debt has remained relatively stable for the six years ending March 31, 2002.

Exhibit 23

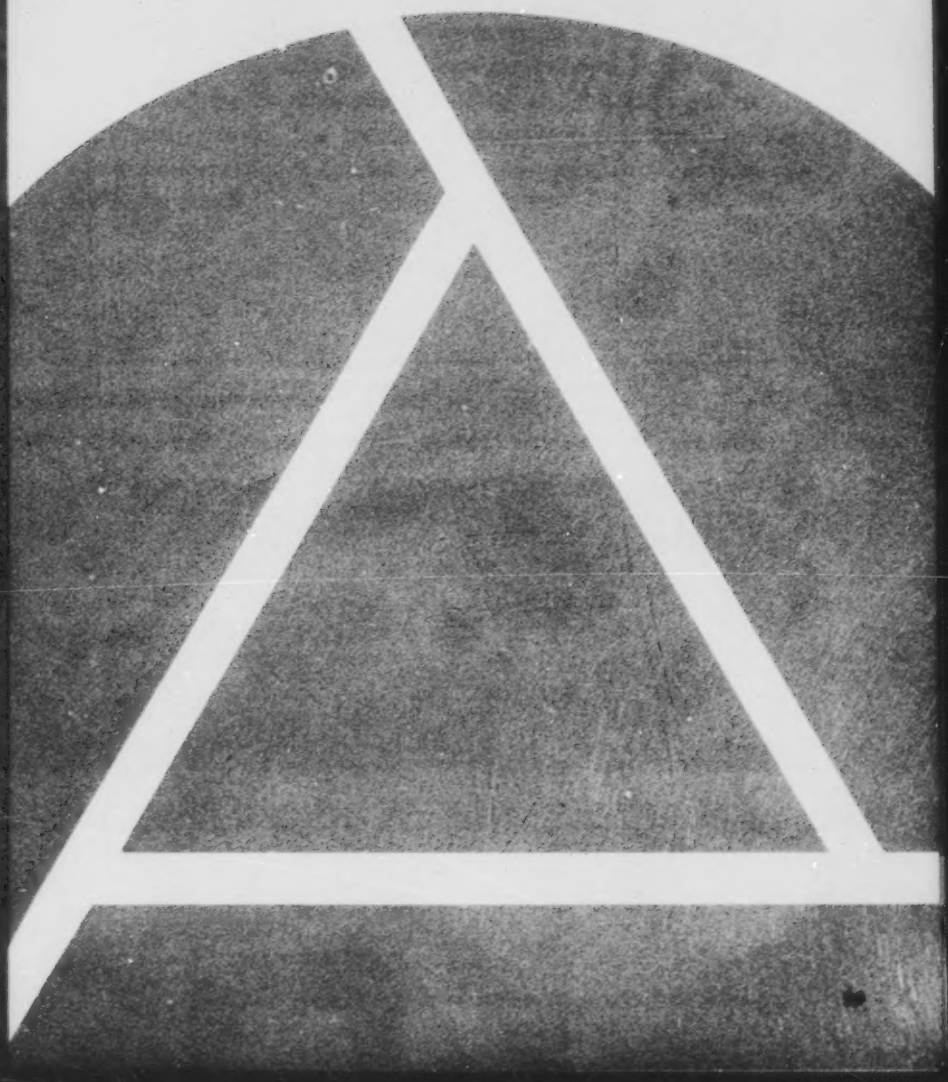
Foreign Currency Debt to Total Government Debt, 1997 to 2002

Non-hedged foreign currency debt as a percentage of total government debt



Source: Office of the Auditor General of British Columbia; Ministry of Finance

Part 2:
Comparing British Columbia to Other Canadian Jurisdictions



The Big Picture—Where Do We Stand?

The government's business can influence, and be influenced by, changes in the economy. On the income side, taxation, resource and other government revenues are closely tied to the performance of British Columbia's economy. A vibrant economy will normally produce greater revenues. In turn, spending that revenue in the province can play an important role in stimulating economic growth.

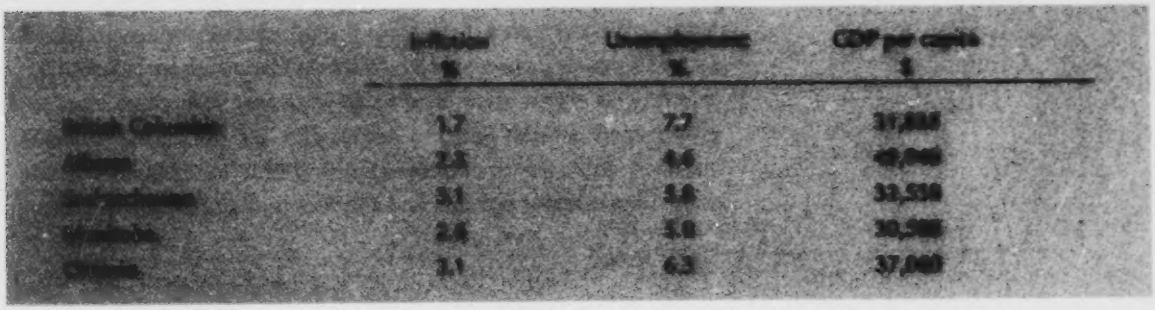
In the 2001/02 fiscal year, in comparison to other western Canadian provinces and Ontario, British Columbia experienced lower inflation, higher unemployment, and (with the exception of Manitoba) lower GDP per capita. Exhibit 24 compares inflation, unemployment and GDP per capita in all western Canadian provinces and Ontario for 2001/02.

Comparing provincial statistical and economic information is not without problem. Much work needs to be done to make such comparisons relevant. For instance, statistical and economic information is constantly being updated, and this can result in significant changes. It is therefore important to ensure that the date of such information is the same when inter-provincial comparisons are being made.

Exhibit 24

Economic Indicators for the Western Provinces and Ontario, 2001/02*

British Columbia has higher unemployment, lower inflation and lower gross domestic product (GDP) per capita



*Inflation, Unemployment and GDP data is for the calendar year ending December 31, 2001. Population data is as at July 1, 2001.

Source: Statistics Canada

The Big Picture—Where Do We Stand?

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British Columbia has higher unemployment, lower inflation and lower gross domestic product (GDP) per capita

	Inflation %	Unemployment %	GDP per capita $
British Columbia	1.7	7.7	31,835
Alberta	2.3	4.6	49,048
Saskatchewan	3.1	5.8	32,538
Manitoba	2.6	5.0	30,508
Ontario	3.1	6.3	37,060

*Inflation, Unemployment and GDP data is for the calendar year ending December 31, 2001. Population data is as at July 1, 2001.

Source: Statistics Canada

Part 2: Comparing British Columbia to Other Canadian Jurisdictions

In addition, the financial information that is produced within each jurisdiction may not be entirely comparable, depending on the accounting policies and reporting entity adopted by each jurisdiction. And, while the absolute dollar value of financial information also makes it difficult to compare provincial finances on a direct basis, the use of ratios and indicators (such as a comparison to GDP or the population), often remove these differences.

In this part of the report, I assess the changes over the last six years of three significant indicators. These indicators, described below, can provide us with a better understanding of our financial performance relative to that of other provinces and the federal government.

1. *Net Liability to GDP*

   This ratio is used to monitor the fluctuation from year–to-year of the province's shortage of financial assets to meet its liabilities, compared to changes in the economy. It is a universal ratio used by all jurisdictions in Canada, and therefore is well established and understood by governments, investors and legislators alike. Sometimes this ratio is referred to as "net debt to GDP."

   In British Columbia the government publishes annually in its Debt Statistics report the ratio of its public debt to GDP. Monitoring that ratio is also appropriate.

2. *GDP Per Capita*

   This ratio is used to monitor the year-to-year changes in the province's economy relative to those in the economy of other jurisdictions. It is calculated by dividing the nominal GDP for a year by the size of the population. Because many external factors tend to have a similar effect on Canadian jurisdictions, this ratio is also widely used as an indicator of success of a government's fiscal policies. Although GDP per capita is not a complete indicator of citizens' standard of living, it does provide some idea of the programs and services that a province can afford.

3. *Credit Rating*

   Another widely used intergovernmental indicator of government financial performance is credit rating. As a service to lenders, credit rating agencies keep watch on changes in the provinces' financial condition and publicly report on them. In

the view of these agencies, British Columbia has been able to keep its high standing in the international financial market, although its ranking has dropped from the highest rated province in Canada to the second highest rated province, after Alberta. British Columbia has maintained a credit rating of Aa2 since 1997/98.

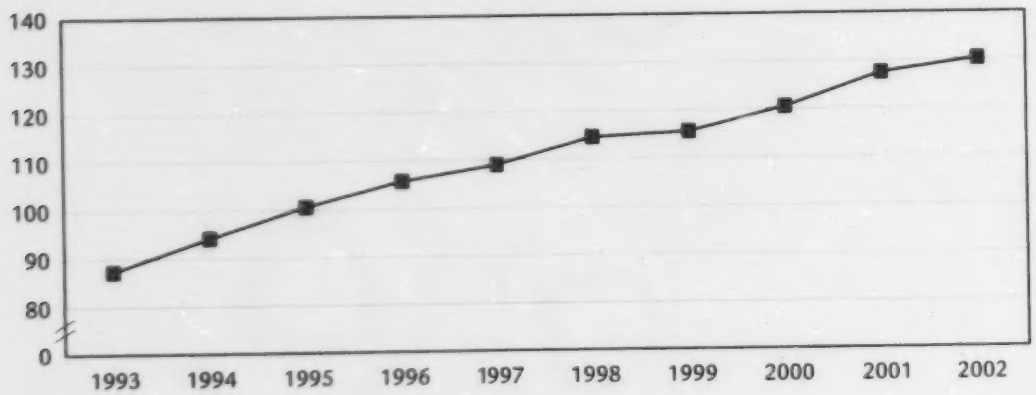
I am pleased to note that the Minister of Finance, in his message on the recently published Debt Statistics report, refers to some of these indicators for comparing British Columbia with other Canadian jurisdictions. I encourage the government to use these indicators as performance measures of success of its overall fiscal policies.

Exhibit 25 shows the GDP for British Columbia for the 10 fiscal years from 1993 to 2002. The graph shows fairly steady growth in the province's GDP over that time, though growth was a little flat in 1998/99. Some of the growth in 2000/01 can be attributed to high energy prices. In 2001/02, GDP was 2.2% higher that in the previous year—the same growth that was projected in British Columbia's fiscal and economic update of July 31, 2001.

Exhibit 25

British Columbia's Gross Domestic Product (GDP), 1993 to 2002*

The GDP represents the size of the provincial economy ($ Billions)



*GDP data is for the calendar year ending in the above fiscal years.

Source: Statistics Canada

Part 2: Comparing British Columbia to Other Canadian Jurisdictions

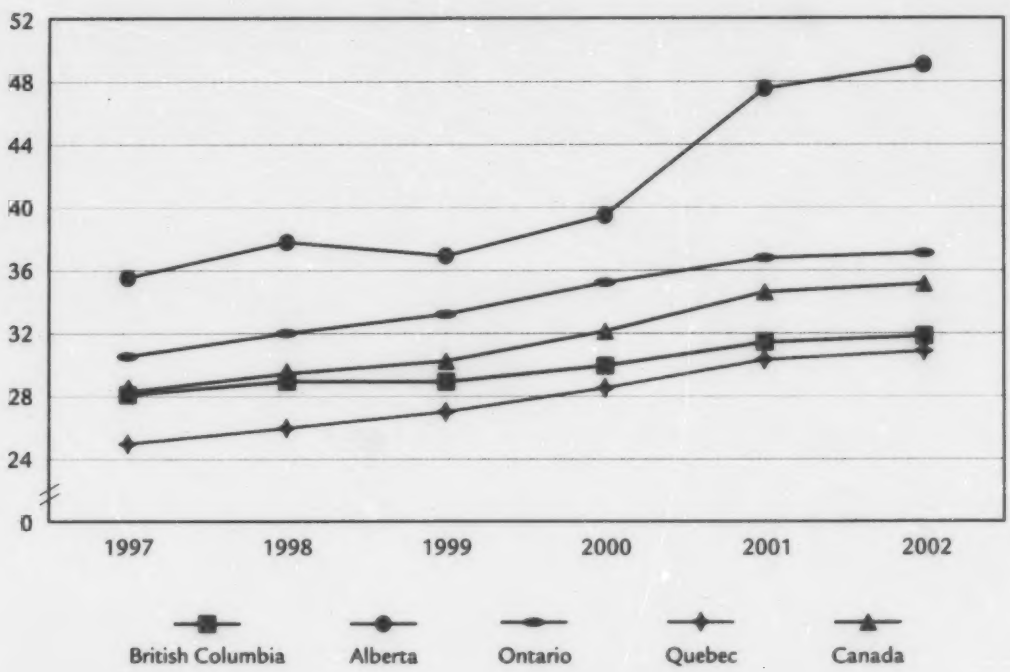
Exhibit 26 presents the GDP per capita for British Columbia, Alberta, Ontario, Quebec and Canada as a whole. Appendix B provides the data for these jurisdictions and the six remaining provinces. This information provides an average output per person for each jurisdiction, and is an indicator of the wealth of the province.

Alberta has the highest GDP per capita in 2002, followed by Ontario and then Canada (the figure for Canada approximates a weighted average of all provinces). British Columbia's GDP per capita ranks fourth among the provinces in 2002, behind Saskatchewan.

Exhibit 26

Gross Domestic Product (GDP) Per Capita, for Canada and four of the Provinces, 1997 to 2002*

A measure of the financial wealth of a jurisdiction ($ Thousands)



*GDP data is for the calendar year ending in the above fiscal years. Population is as at July 1 of the fiscal year.

Source: Statistics Canada

Part 2: Comparing British Columbia to Other Canadian Jurisdictions

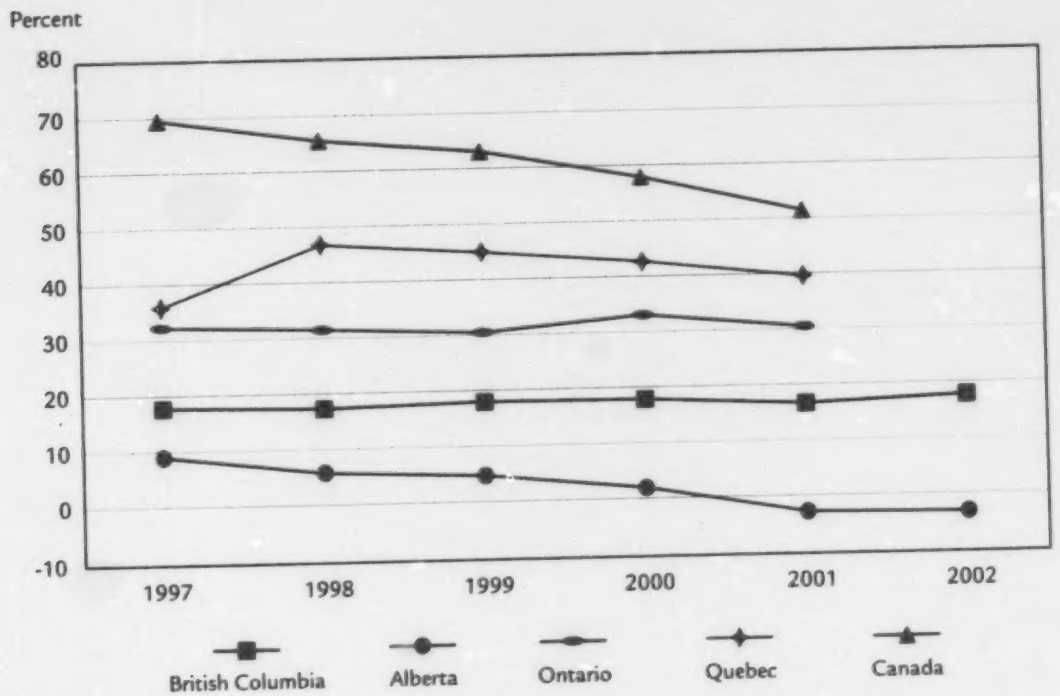
In Exhibit 17 on page 33, I presented the net liabilities to GDP indicator for British Columbia for the six years 1997 through 2002. Net liabilities is the difference between a government's total liabilities and its financial assets. Net liabilities is the amount that current and past generations of British Columbians are leaving to future generations of citizens to pay or finance. Comparing the net liabilities to GDP makes it easier to compare the net liabilities of one year to another, as well as across different jurisdictions.

Exhibit 27 presents the net liabilities to GDP for British Columbia, Alberta, Ontario, Quebec and Canada as a whole, for

Exhibit 27

Net Liabilities to Gross Domestic Product (GDP), for Canada and four of the Provinces, 1997 to 2002*

The extent to which the economy is able to sustain the demands placed on it by the government



*GDP data is for the calendar year ending in the above fiscal years.

Source: Office of the Auditor General of British Columbia; Statistics Canada

years since 1997. Appendix C provides the data for these jurisdictions and the six other provinces. The net liabilities for the other jurisdictions is based on information from their Public Accounts. The only available figures for 2002, at the time I was writing this report, are those of British Columbia, Alberta and Saskatchewan.

For the graphs in Exhibit 27, it is better to have a lower liability ratio than a higher one. Alberta is the only jurisdiction with a "negative" net liability to GDP, in 2002 and 2001. This indicates that Alberta is in a net asset position—it has more financial assets than liabilities.

British Columbia ranks second among all jurisdictions with respect to the net liabilities to GDP indicator, behind Alberta, and has maintained this position for all years since 1997.

Exhibit 28 compares British Columbia's credit rating by Moody's Investors Service to the rating for Alberta, Ontario, Quebec and Canada for each year since March 31, 1993. Appendix D provides the credit ratings for these jurisdictions and the six remaining provinces.

Interesting to note is that since the March 31, 2002 yearend, five jurisdictions have had their credit rating upgraded by one rating: Canada, Saskatchewan, Ontario, Newfoundland and Prince Edward Island. Ontario's rating is now the same as British Columbia's at Aa2.

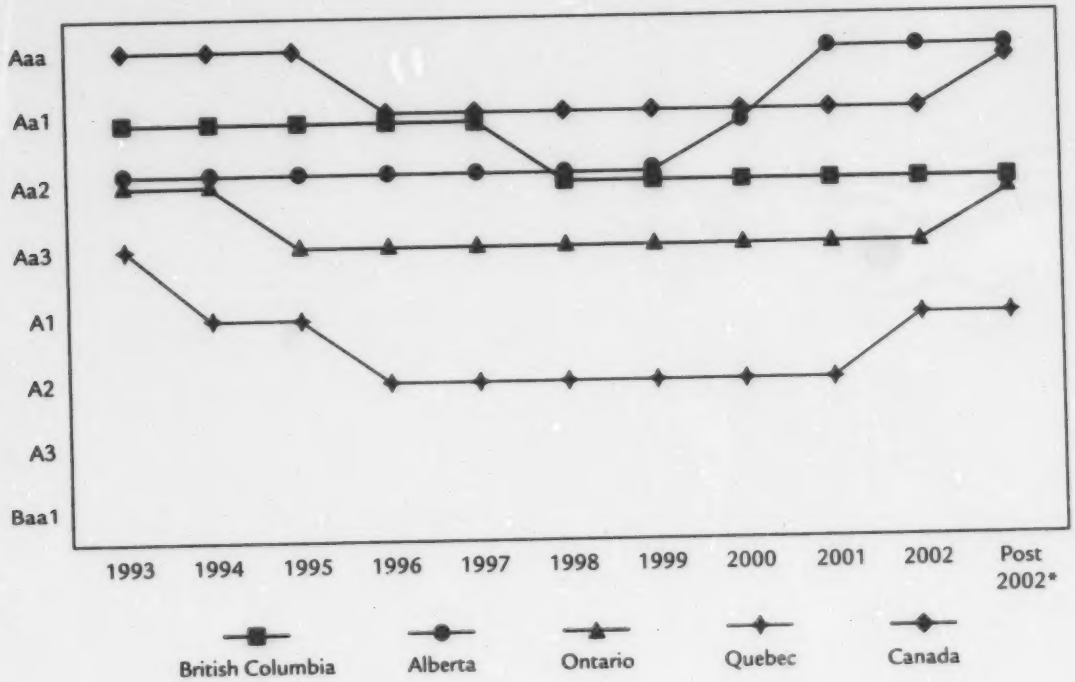
Recommendation:

I recommend that the government use the indicators of financial condition identified by the Canadian Institute of Chartered Accountants, and other important financial and economic measures, to inform the legislators and citizens of British Columbia of the state of the government's finances.

Exhibit 28

Credit Rating, for Canada and four of the Provinces, 1993 to 2002*

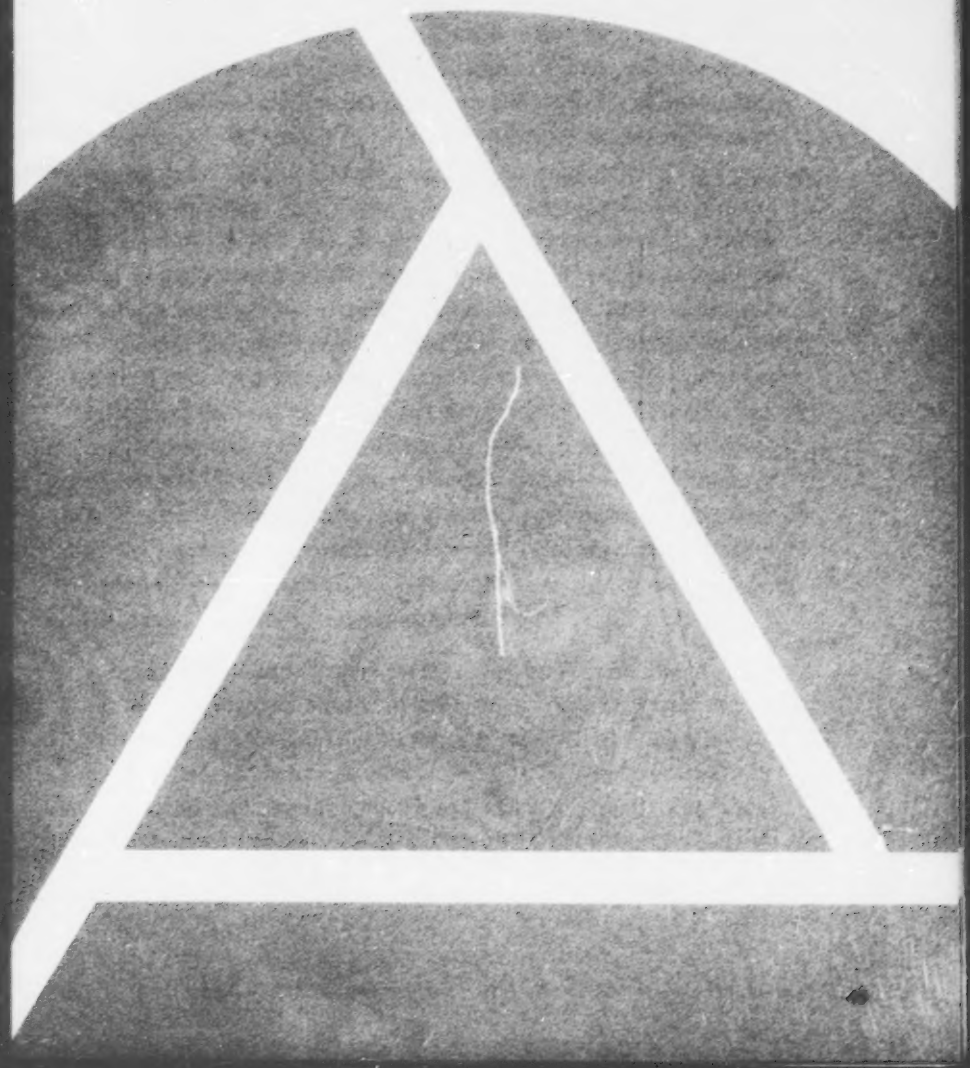
Credit ratings as at March 31 of each year



*Subsequent to March 31, 2002 the credit ratings were amended (post 2002).

Source: Moody's Investors Service

Response from the Ministry of Finance



We appreciate the opportunity to respond to the Auditor General's comments as we feel strongly that the many positive aspects of this province's accountability framework in financial planning and reporting should also be considered when this report is reviewed.

The Province of British Columbia continues to be a leader in Summary budgeting and reporting where the operations of Crown corporations and agencies are fully reflected in our Budget documents and in our Public Accounts. The Budget documents are our financial plan, and the Overview within the Public Accounts reports the actual results against that plan. As well, the province publishes at the same time as the Public Accounts, the audited Debt Statistics report, with accompanying graphs and commentary, and the Economic and Fiscal Review with its expanded details on the actual results. Much of the data the Auditor General includes in his suggested framework is provided in those documents.

In August 2001 and in accordance with its "New Era" commitment, the new government introduced and passed the Budget Transparency and Accountability Amendment Act. As a result, British Columbia was the first province to legislate that it must produce its budget and financial reports in full compliance with Generally Accepted Accounting Principles (GAAP) for senior governments. This reporting standard must be achieved by 2004/05. The province also requires government, ministry, and Crown corporation and agency three-year service plans and reports that disclose goals and objectives and related performance measures to be released with the Budget and Public Accounts. Therefore, the province already provides a detailed accountability loop from planning to reporting. In terms of the timeliness of financial reporting, British Columbia was the second province to release audited financial statements for the recently completed 2001/02 fiscal year. Although we are in the early stages of performance reporting, and there is room for improvement, it is clear that the government has dramatically improved its financial and accountability reporting. We feel that this work should be considered in conjunction with the Auditor General's recommendations.

As the Auditor General points out in his introduction to this report, our audited financial statements are already prepared, for the most part, in accordance with GAAP for senior governments as recommended by the Public Sector Accounting Board (PSAB). In fact, this province is in the forefront for implementing the various recommendations. For instance, very few provinces have capitalized tangible capital assets or have Summary-based Estimates.

Our current exceptions to GAAP are due to the exclusion of Schools, Universities, Colleges and Institutes and Health Care (SUCH sector) entities from the province's Budget and Financial Reports. This is not an unusual exception as very few provinces include all these organizations in their reporting entity. In some cases, exclusion can be justified by the nature of the governance relationship with the provincial government. In other cases, the exclusion is justified by an argument that SUCH sector entities may meet the letter, but not the spirit, of appropriate inclusion in the government reporting entity. It is clear that not all provinces agree with the consolidation of the SUCH sector. We also note that in all but one year, inclusion of the SUCH sector entities would have had a modest positive effect on the BC government bottom line. For several years, we have disclosed the impact of including the SUCH sector entities in our Public Accounts.

Since the province has legislated full compliance with GAAP by fiscal 2004/05, a project is currently under way to determine which of the SUCH entities should be included in the government reporting entity. There are significant policy, technical and administrative issues to be resolved in making any significant change to the government reporting entity and the government is committed to resolving those issues as quickly as possible. However, from the government's perspective, it is unclear whether or not all the SUCH sector entities meet the criteria for inclusion. Inclusion in the government entity has significant consequences for the government and the SUCH sector organizations so the determination is not to be made lightly.

Due to inconsistent application of PSAB guidance across Canada and widespread dissatisfaction with the current reporting entity criteria, PSAB is currently reviewing its government reporting entity recommendations. This review may also include reconsideration of how the SUCH sector is accounted for in financial statements. PSAB is expected to release revised draft recommendations in the near future, and anticipated and actual changes to current recommendations need to be a part of the province's evaluation process.

The province has also referred this issue to the independent Accounting Policy Advisory Committee for consideration and advice.

The format and content of the Estimates and Public Accounts are further complicated by the need for compliance with constitutional issues such as the need for the Legislature to vote on spending from the Consolidated Revenue Fund (CRF). This requires a breakdown of the

spending reported in the Estimates and Public Accounts to separately disclose CRF spending from Crown corporation and SUCH spending. The current structure of the Estimates permits this separation and provides a format for the ultimate accountability for actual spending. Summary schedules are also provided to permit the appropriate level of comparison to the fully consolidated Summary Financial Statements. While the Estimates and Public Accounts have room for improvement, this dual role will continue into the foreseeable future, restricting not only the appropriateness but also our ability to make changes as suggested by the Auditor General.

In addition, governments are extremely complex organizations that use a variety of organizations, from ministries to Crown corporations and agencies, to the SUCH sector, to provide services to the public. From an accountability and transparency perspective, we feel it is important to clearly disclose to the Legislature and the public the distinct components of the "big picture" for completeness and to show how the information is derived. There are significant transactions and transfers between government organizations and some differences in accounting policies. Proper accounting requires that these inter-entity transactions be eliminated and policies adjusted to conform to the broader government standard. We will, therefore, never be able to do away with all the accounting policy and other adjustments that currently exist. In fact some, such as the elimination of the BC Hydro rate stabilization account balance, are done at the explicit request of the Auditor General.

We agree that it is important for governments to provide explanatory context for their financial reports, however, there is no guidance currently provided by the accounting profession. Provinces provide explanatory detail using a wide variety of documents and levels of detail. There is no general use of all the Canadian Institute of Chartered Accountants' Indicators of Government Financial Condition recommended by the Auditor General, in part, because of concerns over their reliability as measures. Some of these indicators, and other indicators, are being used by various jurisdictions, including British Columbia.

An issue of concern for the government, and something we will explore further with the Auditor General, is the assertion that more than GAAP is required to tell the full story. While we agree that GAAP reflects a minimum standard of reporting and as mentioned above may not necessarily be the most transparent standard, it is important that reporting standards not change dramatically from year to year. There is

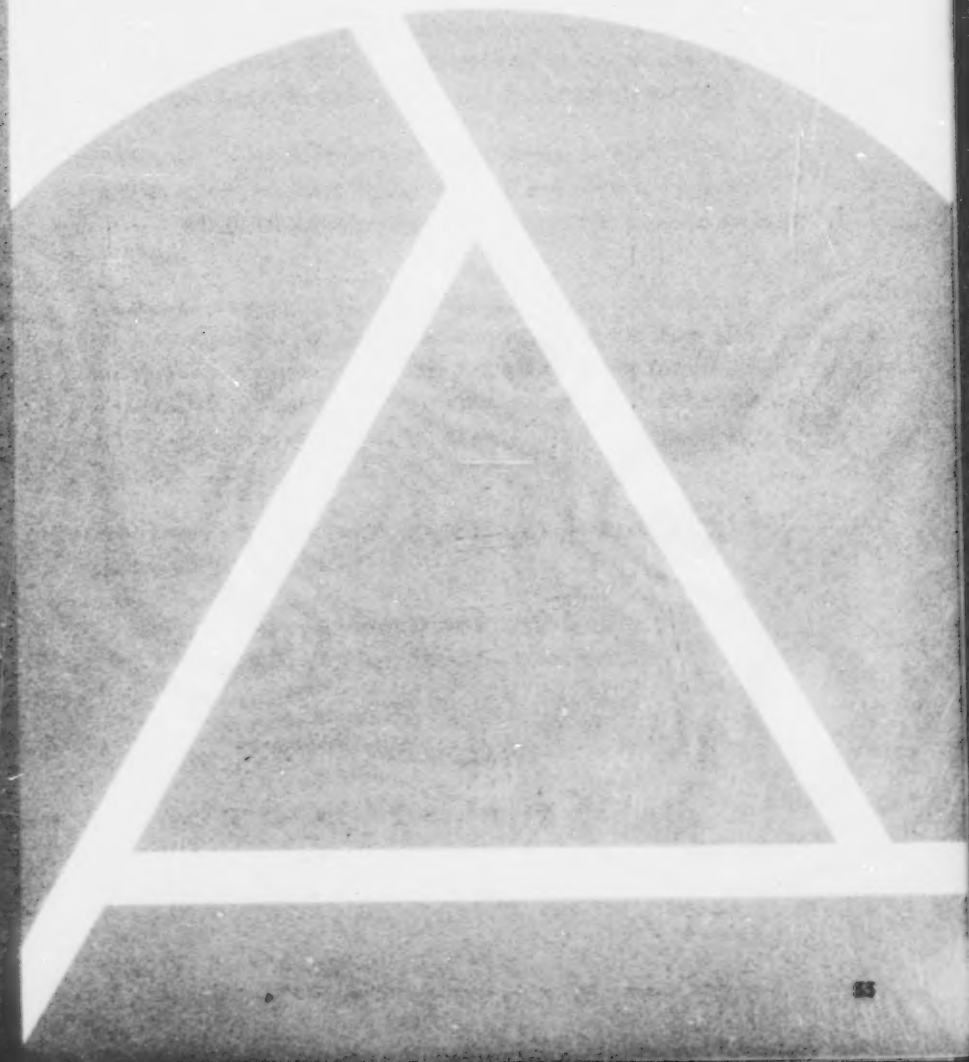
always room for enhancement; however, keeping up with evolving GAAP/PSAB guidance is challenging in its own right—raising the bar will have to be done cautiously, and with general agreement across jurisdictions.

A project has just been initiated by PSAB to review the question of what supplementary material should be provided by governments. We will be working with PSAB and other jurisdictions to develop mutually agreeable principles. However, at this time there is only a draft statement of principles for the development of such recommendations and we are very far from any formal guidance on this issue. We feel that a key part of this project should be consultation with Legislators, taxpayers and other users of our reports.

In British Columbia our current focus is on the legislated requirement to move to full compliance with GAAP by 2004/05. Resolution of the reporting entity (SUCH) issue will deal with much of the Auditor General's concern around the completeness of the information provided in the Estimates and the Public Accounts. While the Auditor General has provided one possible model for presenting supplementary material, and notes himself that it could be improved, we will be exploring these suggestions further, not only with his office but also with other stakeholders and governments. Improvements will be made over time; however, in the immediate future we are concentrating our resources on meeting the legislated commitment of making the Budget documents, Estimates and Summary Financial Statements fully compliant with Generally Accepted Accounting Principles by 2004/05. We look forward to working with the Auditor General on this priority project.

September 2002

Glossary



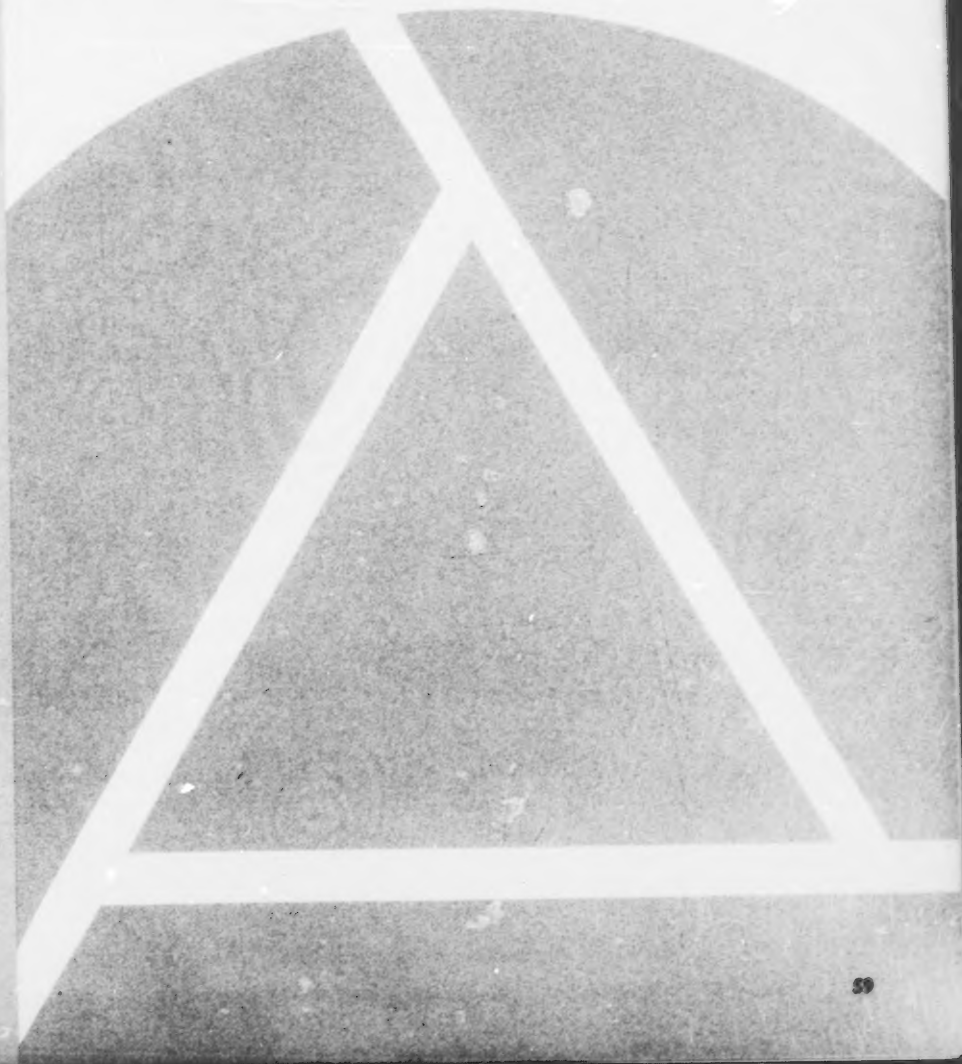
Glossary

Accumulated surplus/deficit	The total of all past annual surpluses and deficits to date.
Annual surplus/deficit	The difference between the government's annual revenues and expenses.
Derivative contract	A "swap" or other financial instrument that is entered into with a third party, and is used to hedge interest rate, foreign currency or other risk exposures.
Enterprises	Also known as commercial, self-supporting, or modified equity enterprises. These are self-sufficient Crown corporations that sell goods or services to parties outside the government reporting entity.
Federal transfers	Funds received by the Province from the Federal government, such as the Canada Health and Social Transfer and Equalization payments.
Financial assets	Assets of government (such as cash, investments, loans and accounts receivable) that can be converted to cash in order to pay government's liabilities or finance its future operations.
General infrastructure assets	Also known as capital assets, physical assets, tangible assets, non-financial assets, physical capital stock. These general program capital assets form the infrastructure necessary to provide services to citizens.
Generally accepted accounting principles (GAAP)	This refers to the accounting policies that government should follow in order to be consistent in its accounting practices with other, similar, organizations. The accepted authority for GAAP for Canadian governments is the recommendations of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA).
General programs	Those activities of government which are not carried out by its profit-oriented enterprises.
Government reporting entity	The group of organizations that are consolidated in the government's main summary financial statements.

Glossary

Gross domestic product (GDP)	The money value of goods and services produced within a geographical boundary. GDP can be reported without adjusting for inflation (known as market value, current, or nominal GDP) or it may be discounted for the effects of inflation (real GDP). GDP in this report is not adjusted for inflation.
Hedging	Reducing potential exposure to foreign currency, interest rate or other risks. Often achieved by entering into derivative contracts with a third party.
Net liabilities	Defined as government's total liabilities less its financial assets, this is the residual liability amount that will have to be paid or financed by future taxpayers.
Public debt	Borrowings of the government. Debt generally consists of debentures, notes payable, capital leases and mortgages.
Public debt charges	Also known as the cost of borrowing, or debt servicing costs, this is the interest incurred by government on its borrowings.
SUCH sector	Refers to school districts, universities, colleges and health authorities.
Summary financial statements	The financial statements through which government reports its financial position and operating results.

Appendices



Provincial Financial Reporting Overview

Summary Accounts Surplus (Deficit)
for the Fiscal Year Ended March 31, 2002

Summary Accounts Accumulated Surplus (Deficit)
for the Fiscal Year Ended March 31, 2002

Detailed Summary Accounts Surplus (Deficit)
for the Fiscal Years Ended March 31, 1998 to 2002

Summary Accounts Surplus (Deficit) for the Fiscal Year Ended March 31, 2002

In Millions

	2001/02 Estimates[1]	2001/02 Actual	2000/01 Actual
Consolidated Revenue Fund	$	$	$
Revenue	22,737	22,962	24,013
Expense[2]	(24,808)	(24,913)	(22,465)
	(2,071)	(1,951)	1,548
Liquidation dividend		256	
	(2,071)	(1,695)	1,548
Crown Corporations and Agencies			
Taxpayer–supported Crown corporations and agencies	(333)	(518)	(227)
Self–supported Crown corporations and agencies (net of dividends paid to the Consolidated Revenue Fund)	66	(484)	157
Net Crown corporations and agencies' operating result	(267)	(1,002)	(70)
Summary account surplus (deficit) before forecast allowance and Joint Trusteeship Agreements	(2,338)	(2,697)	1,478
Forecast allowance[3]	(500)		
Gain (loss) on pension settlement	1,338	1,464	(52)
Summary accounts surplus (deficit)	**(1,500)**	**(1,233)**	**1,426**

[1]Estimates 2001/02.

[2]Consolidated Revenue Fund expense includes restructuring exit expenses.

[3]This allowance in the Estimates numbers is to provide for spending pressures or revenue reductions that could not be anticipated at the time the Estimates were prepared.

Summary Accounts Accumulated Surplus (Deficit) for the Fiscal Year Ended March 31, 2002

In Millions

	2001/02 Actual	2000/01 Actual
	$	$
Summary accounts accumulated surplus (deficit)—beginning of year	(3,509)	(4,970)
Adjustments[1]	32	35
Summary accounts accumulated surplus (deficit)—beginning of year—as restated	(3,477)	(4,935)
Summary accounts surplus (deficit)	(1,233)	1,426
Summary accounts accumulated surplus (deficit)—end of year	**(4,710)**	**(3,509)**

[1]See Note 26 Accumulated Surplus (Deficit) of the Summary Financial Statements for additional information.

Detailed Summary Accounts Surplus (Deficit) for the Fiscal Years Ended March 31

In Millions

	2001/02 Estimates	2001/02 Actual	2000/01 Actual[1]	1999/00 Actual[1]	1998/99 Actual[1]	1997/98 Actual[1]
Consolidated Revenue Fund (CRF)	$	$	$	$	$	$
Operating result before joint trusteeship[2] ...	(2,071)	(1,695)	1,548	(383)	(281)	81
Taxpayer–supported Crown Corporations and Agencies[3]						
BC Transportation Financing Authority.....			1	22	(114)	52
British Columbia Buildings Corporation	40	37	51	45	49	39
British Columbia Ferry Corporation.....	3	(23)	11	(299)	(114)	(59)
Forest Renewal BC	(107)	(179)	(64)	1	(265)	(88)
552513 British Columbia Ltd (Skeena Cellulose Inc).....	(53)	(69)				
Other	(7)	(6)	32	(44)	9	40
	(124)	(240)	31	(275)	(435)	(16)
Net transfers from (to) the CRF.....	(18)	(273)	(69)	(78)	(14)	(20)
Other accounting adjustments[4].....	(191)	(5)	(189)	949	(368)	(278)
	(333)	(518)	(227)	596	(817)	(314)
Self–supported Crown Corporations and Agencies[3]						
British Columbia Hydro and Power Authority.....	420	403	446	416	395	408
British Columbia Liquor Distribution Branch.....	616	637	642	617	616	606
British Columbia Lottery Corporation	585	606	562	532	456	290
British Columbia Railway Company.....	1	(107)	(7)	(582)	24	40
Insurance Corporation of British Columbia	35	(251)	139	96	74	14
Other	3		4	1	(23)	(24)
	1,660	1,288	1,786	1,080	1,542	1,334
Net transfers from (to) the CRF.....	(1,393)	(1,420)	(1,431)	(1,376)	(1,348)	(1,260)
Other accounting adjustments[5].....	(201)	(352)	(198)	106	(99)	(8)
	66	(484)	157	(190)	95	66
Forecast allowance.....	(500)					
Gain (loss) on pension settlement.....	1,338	1,464	(52)			
Summary accounts surplus (deficit).....	**(1,500)**	**(1,233)**	**1,426**	**23**	**(1,003)**	**(167)**

[1]Figures have been restated to reflect material changes in government accounting policies.

[2]Consolidated Revenue Fund operating result includes the liquidation dividend from Forest Renewal BC and restructuring exit expenses.

[3]See pages 72 and 73.

[4]Fiscal 2001/02 includes adjustments made to transfer the revenue recognition of deferred capital contribution ($187 million) to contributed surplus in the BC Transportation Financing Authority.

[5]Fiscal 2001/02 includes transfers of British Columbia Lottery Corporation revenue to charities and local governments, adjustments to the British Columbia Hydro and Power Authority rate stabilization account, and adjustments to the Insurance Corporation of British Columbia and the British Columbia Railway Company financial results to bring them in line with the government fiscal year.

The ratio of GDP per capita for all provinces and Canada, for the fiscal years 1997 to 2002*

(Dollars)

	1997	1998	1999	2000	2001	2002
British Columbia	28,091	28,940	28,923	29,942	31,427	31,835
Alberta	35,504	37,776	36,900	39,460	47,535	49,048
Saskatchewan	28,513	28,589	28,402	29,340	32,791	32,538
Manitoba	25,125	26,218	27,164	27,811	29,476	30,508
Ontario	30,516	31,996	33,207	35,201	36,759	37,060
Quebec	24,960	25,952	26,994	28,502	30,290	30,835
Newfoundland	18,627	19,088	20,628	22,863	26,222	26,060
New Brunswick	22,134	22,398	23,344	24,785	26,105	26,699
Nova Scotia	20,991	21,817	22,802	24,449	25,570	26,423
Prince Edward Island	20,801	20,496	21,745	22,572	24,232	24,626
Canada	28,278	29,437	30,249	32,149	34,611	35,141

*GDP data is for the calendar year ending in the above fiscal years. Population as at July 1 of the fiscal year.

Source: Statistics Canada

The ratio of net liabilities to GDP for all provinces and Canada, for the fiscal years 1997 to 2002*

(Percent)

	1997	1998	1999	2000	2001	2002
British Columbia	17.69	17.25	17.91	17.83	16.71	17.73
Alberta	8.82	5.58	4.55	1.78	-3.01	-3.36
Saskatchewan	32.14	30.71	30.38	27.99	24.54	26.34
Manitoba	29.31	28.36	27.91	30.60	27.84	
Ontario	32.11	31.32	30.34	32.91	30.36	
Quebec	35.71	46.63	44.81	42.56	39.47	
Newfoundland	69.42	69.04	69.84	65.38	59.92	not available
New Brunswick	32.66	34.04	33.63	36.43	33.62	
Nova Scotia	42.82	45.55	48.19	48.87	47.16	
Prince Edward Island	35.91	36.40	33.37	32.42	31.25	
Canada	69.50	65.67	63.04	57.57	51.40	

*GDP data is for the calendar year ending in the above fiscal years.

Source: Office of the Auditor General of British Columbia; Statistics Canada

Credit rating for all provinces and Canada, as at March 31 for the fiscal years 1993 to 2002*

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Post 2002*
British Columbia	Aa1	Aa1	Aa1	Aa1	Aa1	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2
Alberta	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa1	Aaa	Aaa	Aaa
Saskatchewan	A3	A3	A3	A3	A3	A3	A2	A2	A1	A1	Aa3
Manitoba	A1	A1	A1	A1	A1	A1	Aa3	Aa3	Aa3	Aa3	Aa3
Ontario	Aa2	Aa2	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa2
Quebec	Aa3	A1	A1	A2	A2	A2	A2	A2	A2	A1	A1
Nova Scotia	A2	A3	A3	A3	A3	A3	A3	A3	A3	A3	A3
New Brunswick	A1	A1	A1	A1	A1	A1	A1	A1	A1	A1	A1
Newfoundland	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	A3
Prince Edward Island	A3	A3	A3	A3	A3	A3	A3	A3	A3	A3	A2
Canada	Aaa	Aaa	Aaa	Aa1	Aa1	Aa1	Aa1	Aa1	Aa1	Aa1	Aaa

*Subsequent to March 31, 2002 the credit ratings were amended (post 2002).

Source: Moody's Investors Service

Report 1

Building a Strong Work Environment in British Columbia's Public Service: A Key to Delivering Quality Service

Report 2

Follow-up of Performance Reports

Report 3

A Review of Financial Management Issues in the Office of the Police Complaint Commissioner

Report 4

Monitoring the Government's Finances